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ABSTRACT

This document presents witness testimony and supplemental materials from a Congressional hearing regarding legislation to reform national telecommunications policy. Most of the proposed changes would allow Americans greater freedom to choose among communication products and services. Among the topics this hearing addresses are increasing competitiveness of telephone services, cable rate deregulation, and the removal of government-imposed barriers to new investment in and ownership of broadcasting stations. Testimony is included from: (1) Decker Anstrom, National Cable Television Association; (2) Richard H. Cutler, Small Cable Business Association; (3) U. Bertram Ellis, Jr., Ellis Communications, Inc.; (4) Edward O. Fritts, National Association of Broadcasters; (5) Scott Blake Harris, Federal Communications Commission; (6) Gerald L. Hassell, Bank of New York; (7) Roy Neel, United States Telephone Association; (8) Eli Noam, Columbia Institute for Tele-Information; (9) Preston R. Padden, Fox Broadcasting Co.; (10) Bradley Stillman, Consumer Federation of America; and (11) Jim Waterbury, NBC Affiliates Association. The document also features statements by Senators Larry Pressler, Conrad Burns, and John D. Rockefeller. (BEW)

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HEARING ON TELECOMMUNICATIONS POLICY REFORM

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ED 390 420

HEARING

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 21, 1995

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HEARING ON TELECOMMUNICATIONS POLICY REFORM

TUESDAY, MARCH 21, 1995

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SR-253, Russell Senate Office Building, Hon. Larry Pressler (chairman of the committee) presiding.

Staff members assigned to this hearing: Donald McClellan, counsel, and Katherine A. King, counsel; and John D. Windhausen, Jr., minority counsel, and Kevin Joseph, minority professional staff member

OPENING STATEMENT OF SENATOR PRESSLER

The CHAIRMAN. I call this meeting to order. I thank everyone for being with us today. I have a brief opening statement that I will place in the record, but I believe we will call the witnesses forward.

[Prepared statement of Senator Pressler follows:]

PREPARED STATEMENT OF SENATOR PRESSLER

We are nearing the end of what I believe will prove a very fruitful process of bipartisan work for a new law on telecommunications. On Thursday the Commerce Committee will meet to mark up legislation to give Americans unprecedented freedom to choose among communications products and services. This freedom will be the catalyst for innovations in health care, in education, and in other vital social services. This freedom will be key to growth in investment, sales, profits and jobs for Americans competing in the global economy.

Today it is my pleasure to welcome three panels of distinguished witnesses to address the topics of cable rate deregulation; questions of ownership limits and spectrum flexibility for broadcasting stations; and the limits on foreign ownership of U.S. telecommunications enterprises. These are significant issues of change in the upcoming telecommunications deregulation legislation in the 104th Congress.

I look forward to a robust discussion of deregulating cable TV rates. The federal price control system has caused booming growth in bureaucracy at the FCC. Cable meanwhile has direct competition from the direct broadcast satellite (DBS) and "wireless cable" media. It is unfair as well as unproductive to single out this industry for federal price controls.

I also strongly support lifting the limits now imposed on ownership and investment in broadcasting stations. Electronic media today are so diverse and so competitive that there is no realistic threat of any untoward concentration if we remove government-imposed barriers to new investment in broadcast stations. Indeed, increased investment in radio stations, for example, is likely to improve the quality of news and other programming to benefit the listening public. The reform bill I am working to pass also would allow broadcasters opportunity and flexibility in offering supplemental electronic communications through use of digital technology.

The United States is the world leader in telecommunications products, software and services. Still, we labor under self-defeating limits on our ability to grow at home and compete abroad. Most foreign countries retaliate for the strict U.S. limits on foreign investment. This keeps us out of markets where we would have the natural competitive advantage and leaves them open to our competitors. Telecommunications innovation and productivity are flourishing in such countries as the United Kingdom, which has eliminated all barriers to foreign investment. We should pass new legislation to lift limits on foreign investment in U.S. telecommunications enterprises on a fair, reciprocal basis.

The CHAIRMAN. Let us call the first panel forward: Mr. Decker Anstrom, Mr. Richard Cutler, Mr. Gerald Hassell, Mr. Roy Neel, Mr. Bradley Stillman. If they would come forward and take their seats, we can proceed. I will call on Decker Anstrom first.

STATEMENT OF DECKER ANSTROM, PRESIDENT AND CEO, NATIONAL CABLE TELEVISION ASSOCIATION

Mr. ANSTROM. Good morning, Mr. Chairman and members of the committee. Thank you for giving us the opportunity to testify this morning.

Our message today is simple: We support telecommunications legislation because the cable television industry is ready to compete. But if we are to compete successfully, legislation must include rate relief for cable companies.

Our systems today pass over 95 percent of homes in the U.S., and carry up to 900 times more information than telephone facilities. Already several leading cable companies are building state-of-the-art communications facilities that deliver voice, video and data over the same wire.

Put simply, if this committee wants to bring competition to the local phone monopoly, we are it. We are the other wire. Cable has the infrastructure, the technology, the expertise, and the desire to compete with the local phone industry. What we do not have is sufficient capital or, in most States, the legal authority to compete in the local loop.

We hope Congress will remedy the latter obstacle with legislative measures to open up the local phone markets to competition. But if legislation does not also include some relief from the 1992 Cable Act's rate regulation provisions, then these pro-competitive measures will not be adequate to create real competition, because we will not be able to raise the capital needed to compete.

Let me explain. Both the cable and phone industries must raise tens of billions of dollars to put new information technologies and services in place. In this competition for capital, telcos have a huge head start. Cash flow for the seven RBOC's is seven times greater than that of major cable companies. Telco annual revenues are four times greater than those of the cable industry.

This disparity, Mr. Chairman, is exaggerated by the costly, complex, and constantly changing regulations on the pricing, packaging and marketing of cable services that are imposed by the 1992 Cable Act. These rate regulations have weakened cable companies, and made financing for new infrastructures much more difficult to obtain.

The cable industry's capital crunch is no theoretical matter. Faced with emerging competition and stringent regulation, 14 major cable companies have already folded their cards and merged with or been acquired by other companies. In the only independent analysis of the consequences of rate regulation on the cable industry, the Economic Resource Group concluded the cable industry "is finding it increasingly difficult to obtain investment capital with which to build the national information infrastructure."

That is why we strongly believe Congress should revise the Cable Act's definition of effective competition, which dictates when price regulations can be lifted.

Under the current statute, these regulations continue until a cable company loses 15 percent of its market share—a level sufficient to cripple a cable company. That definition should be revised to reflect the telephone companies' legal authorization to enter the cable TV market, rather than the loss of an arbitrary amount of market share.

Mr. Chairman, we know that the issue of cable prices has been a controversial one. But a lot has changed since Congress last considered this issue 3 years ago. Cable prices have been slashed by 17 percent. Most importantly, competition is here. And consumers will have choices they did not have 3 years ago.

A direct broadcast satellite has arrived, and it is the most successful major new product in consumer electronics history. Today, you can walk into any Circuit City store and purchase an 18-inch satellite dish that provides all the programming services available on cable, and more.

And just last week, Direct TV announced three additional manufacturers have been authorized to manufacture DBS dishes, which may bring dish prices down to $399 next year.

That is competition.

Cable is also confronting a terrestrial threat from the original—pardon me, Roy—800-pound gorillas, the local phone monopolies. When Congress passed the 1992 Cable Act, you left the restrictions on telcos entering the cable market. Now the courts have lifted those cross-ownership restrictions. And the FCC is giving the green light to build video dial tone facilities. And among the proposal you are considering today, one would put the phone companies into our business on the day the law becomes enacted.

These choices will constrain cable prices. But, most importantly, with rate relief, cable companies will be able to attract the investment capital they need to compete with the giant telephone monopolies. If we do not do that, no one else will. That is what is at stake. Thank you.

[The prepared statement of Mr. Anstrom follows:]

Statement of Decker Anstrom
President and CEO
National Cable Television Association

regarding

Legislation to Reform National Telecommunications Policy

before the

Committee on Commerce, Science, and Transportation
United States Senate
Washington D.C.

March 21, 1995

TESTIMONY OF DECKER ANSTROM
EXECUTIVE SUMMARY

There is a strong need to replace ad hoc decisions by the courts and regulatory agencies with a comprehensive national policy that will promote the development of America's information infrastructure. NCTA strongly supports this committee's efforts to develop legislation that will foster competition and spur the development of new telecommunications services.

Cable operators now have in place broadband facilities that can serve 97 percent of American homes. The cable industry is also a leader in the use of fiber optic and digital compression technology. These enhancements will ultimately allow cable companies to deliver virtually every type of communications service. As such, **cable television companies are the most likely competitors to local phone monopolies** -- which now entirely dominate the local telephone business.

While cable companies have the technology and expertise necessary to compete with local telephone companies, they face several substantial impediments. First, state and local barriers to competition preclude them from entering most local telecommunications markets. Second, cable companies suffer a significant disadvantage vis-à-vis local phone companies in raising money -- a critical element in making competition a reality and getting the information superhighway built. For example, local telephone companies have annual revenues of $100 billion and seven times the cash flow of cable companies. Third, rate regulations exacerbate this competitive imbalance by making lenders reluctant to invest in the cable industry. As long as regulatory restrictions remain in place, cable companies will not be able to obtain the financing necessary to compete with the telephone companies. Indeed, these regulations have already had adverse consequences for both cable operators and programmers.

The current definition of "effective competition" in the 1992 Cable Act is flawed since it maintains costly regulations on the pricing, packaging, and marketing of cable channels until cable operators lose 15 percent of their customer base. In fact, the cable television industry is already facing significant competitive pressures from the telephone companies, which are gaining entry into the television business through the federal courts and the FCC's video dialtone proceedings. In addition, the cable industry faces real and growing competition from the direct broadcast satellite industry. For example, DBS services offered by non-cable affiliated providers such as USSB and DirecTV expect to serve 2 million homes by the end of 1995.

Cable companies will not be able to secure the financing necessary to compete with the entrenched local exchange monopolies unless they obtain rate relief in their core business (the expanded programming tiers) as soon as telephone companies are authorized to enter the video business. As such, the definition of effective competition -- the trigger for cable rate relief -- should be modified to reflect the telephone companies' legal authorization to enter the video market, rather than the loss of an arbitrary amount of a cable company's market share.

TESTIMONY OF DECKER ANSTROM
MARCH 21, 1995

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I. INTRODUCTION

Mr. Chairman, members of the committee, my name is Decker Anstrom and I am President and CEO of the National Cable Television Association (NCTA). Thank you for inviting me to testify before you today on behalf of the NCTA, which represents more than 100 cable programming networks and most of the cable operators serving our nation's 61 million cable subscribers. We welcome this opportunity to comment on pending legislative proposals to update the Communications Act of 1934.

As this committee is aware, technology is changing quickly and will soon allow consumers to choose between competing providers of advanced voice, video, and data services. There is a strong need to replace ad hoc decisions by the courts and regulatory agencies with a comprehensive national policy that will promote the development of America's information infrastructure. NCTA strongly supports this committee's efforts to develop legislation that will foster competition and spur the development of new telecommunications services.

Cable operators now have in place broadband facilities that can serve 97 percent of American homes. The cable industry is also a leader in the use of fiber optic and digital compression technology. These enhancements will ultimately allow cable companies to deliver virtually every type of communications service. As such, **cable television companies are the most likely competitors to local phone monopolies** – which now entirely dominate the local telephone business.

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II. THE TELECOMMUNICATIONS MARKET TODAY

There is a fundamental imbalance in the telecommunications market today: at the same time that cable faces competition from DBS, MMDS, and telephone companies, cable operators cannot offer telephone service in most states by virtue of state and local barriers to entry (see Appendix B, "Status of Local Exchange Competition in the United States"). Even in the 14 states that are taking some action to allow competition in the local loop, telephone companies can use bureaucratic delays to fight new entrants at every turn. For example, it took six years for competitive access providers (CAPs) in New York and Illinois to beat back administrative challenges by the incumbent Bell Operating Companies and win regulatory approval to provide local exchange service – even though they had the statutory authority to do so.

The primary challenge for Congress is to open up the local loop to competition and give consumers choices from among several different telecommunications providers. In the meantime, local exchange companies continue to monopolize the provision of voice and data services in their markets.

A. TELEPHONE COMPANIES STILL MONOPOLIZE LOCAL EXCHANGE MARKETS

While other American telecommunications companies prepare for a vigorously competitive marketplace, local telephone exchange companies (LECs), and especially the seven Regional Bell Operating Companies (RBOCs), continue to maintain their dominant, monopoly position in the telephone marketplace. In comparison to other telecommunications firms, LECs:

- are four times bigger than the cable industry in annual revenue;
- have significantly better access to capital markets;
- dominate most new markets they enter; and
- still handle more than 99 percent of all local telephone calls.

Despite financial and technological hurdles, many entrepreneurs are taking substantial risks to compete with the incumbent local telephone companies. These new service providers face rich, well-entrenched incumbents which benefit from large and secure revenue streams from their core monopolies, leaving competitive providers only a tiny share of the telephone market. Further, despite their dominant monopolies, RBOCs have slashed jobs and reduced investment in the local telephone network, while increasing investment in new, high risk ventures without insuring that residential telephone users are sufficiently protected from subsidizing these costs.

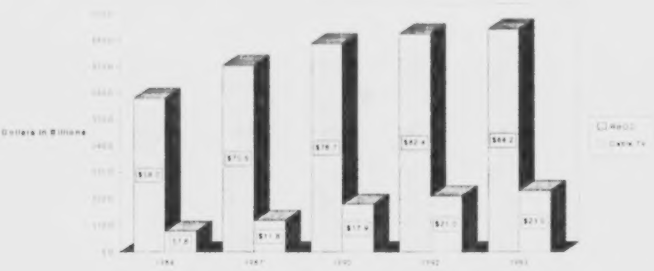
The following data demonstrate the continuing dominance the telcos maintain in the local exchange market, and argue that public policy makers should take great care prior to allowing local phone companies to enter new lines of business – or else face the prospect of the local phone companies creating new, even larger, monopolies.

1. SIZE

Local telephone companies are extraordinarily large and powerful entities. For example, as the following charts illustrate, revenue for the seven RBOCs far exceeds that of the broadcast, cable, and motion picture industries combined. Indeed, their revenue even surpasses the Gross National Product (GNP) of several industrialized nations, including Egypt, Israel, and Venezuela.

Unlike the cable industry, the local exchange business is extremely profitable, generating $6.8 billion in earnings during 1993.[1] Local phone company revenue has grown by almost 45 percent since the divestiture of AT&T in 1984, making RBOCs among the most profitable corporations in America. Not surprisingly, four of the top 50 U.S. companies are RBOCs.[2]

ANNUAL REVENUES OF THE RBOCS VS. CABLE TV
1984-1993



Source: RBOC Annual Reports, Paul Kagan Associates, Inc., *The Cable TV Financial Databook*, June 1994, p. 9 (revised)

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[1] Earnings before extraordinary items and changes in accounting principles.
[2] *Forbes*, April 25, 1994, p. 209.

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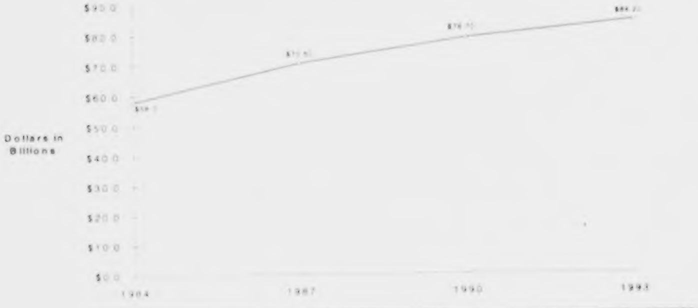
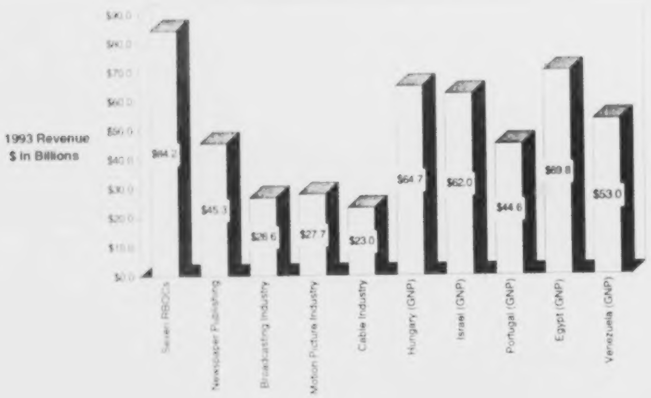
RBOC ANNUAL REVENUE, 1984 – 1993



Source: RBOC Annual Reports

RELATIVE SIZE OF THE RBOCS

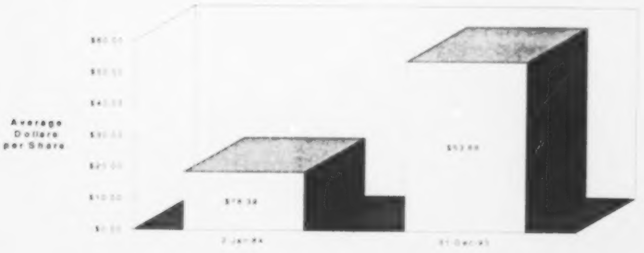


Source: *Statistical Abstract of the United States*; Veronis Suhler & Associates, *Communications Industry Forecast 1994–1998*, pp. 83, 136, 174; Paul Kagan Associates, Inc., *The Cable TV Financial Databook*, June 1994, p.9 (revised); RBOC Annual Reports

2. RELATIVE FINANCIAL STRENGTH

The local telephone companies, by the nature of their monopoly revenue streams, bring enormous financial resources to bear on any business in which they wish to compete. For example, the value of telephone company stock has jumped an average of 192 percent in the past ten years. Moreover, the telephone companies' ability to raise money in debt and equity markets is very strong, as shown by the high quality ratings given to their debt offerings and their relatively low cost of capital.

RBOC AVERAGE STOCK PRICES, JANUARY 2, 1984 AND DECEMBER 31, 1993



Source: *USA Today*, August 23, 1993, p. 2B. *Telephone Company Shareholder Services*

BOND RATINGS, 1993 – 1994

RBOCs	Ameritech	A1+
	Bell Atlantic	A+
	BellSouth	AAA
	NYNEX	A
	Pacific Telesis	B+
	Southwestern Bell	A+
	U S West	A+
Cable	TCI	BBB–
	Comcast	BB
	Jones	BB
	Time Warner	BBB–

Source: *Standard and Poor's Bond Ratings Desk*, November 29, 1994. Ameritech's rating is for commercial paper only. Southwestern Bell has changed its name to SBC Communications.

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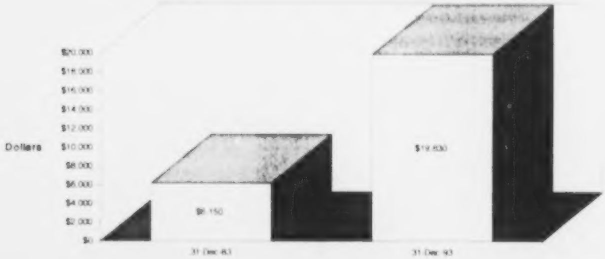
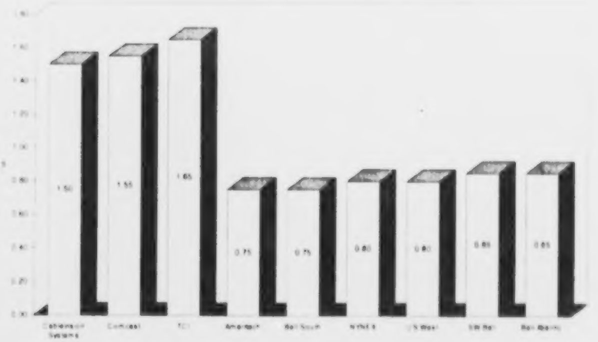
VALUE OF 100 SHARES OF RBOC AND AT&T STOCK BEFORE DIVESTITURE AND AT THE END OF 1993



Source: *USA Today*, August 23, 1993, p. 2B. When AT&T was split up, investors with 100 shares of AT&T got 100 shares of the slimmed-down AT&T, plus 10 shares in each of the seven regional Bells. The original 100 share investment (worth $6,150 on December 31, 1983) was worth $19,830 as of December 31, 1993. The 100 original shares have grown to 375 shares due to stock splits. *Telephone Company Shareholder Services*

RELATIVE EQUITY COST OF CAPITAL FOR CABLE AND TELEPHONE COMPANIES



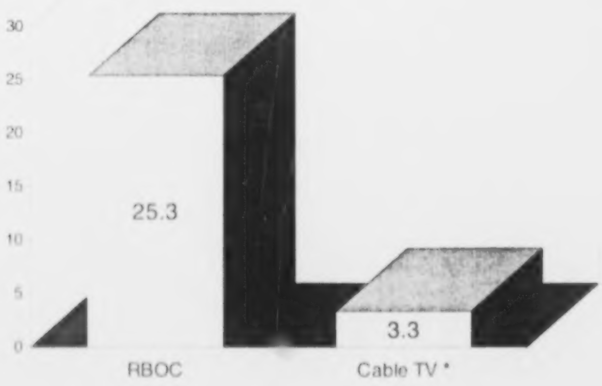
Source: Equity cost of capital reflects the ease with which a company can raise investment capital in order to expand its business. β is a key parameter for measuring equity cost of capital; the lower the beta or risk, the easier capital is to acquire. β given here are from *Value Line*, an independent and widely used source of investment information, in "Ratings and Reports," October 14, 1994. Pacific Telesis had "No Meaningful Figure" to report.

3. CASH FLOW

Cash is critical to businesses: without it, they cannot function. When companies are healthy and strong, their operating activities will generate cash for capital expenditures, investments in infrastructure, and financing new businesses.

As the following two charts demonstrate, the RBOCs' cash flow[3] is much greater than the cable industry's. Indeed, cash flow for the largest cable company (TCI) is less than half that of the RBOC with the smallest cash flow (Pacific Telesis).

RBOC CASH FLOW VS. CABLE TV CASH FLOW IN 1993



Source: Telecommunications, *Financial Information on 16 Telephone and Cable Companies*, U.S. General Accounting Office, July 1994, p. 14.

* This figure includes only the 5 largest publicly held Cable TV companies.

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[3] Cash flow or cash receipts less cash disbursements is often calculated indirectly by summing operating income with depreciation, generally the largest of a firm's noncash expenses, and any other noncash expenses.

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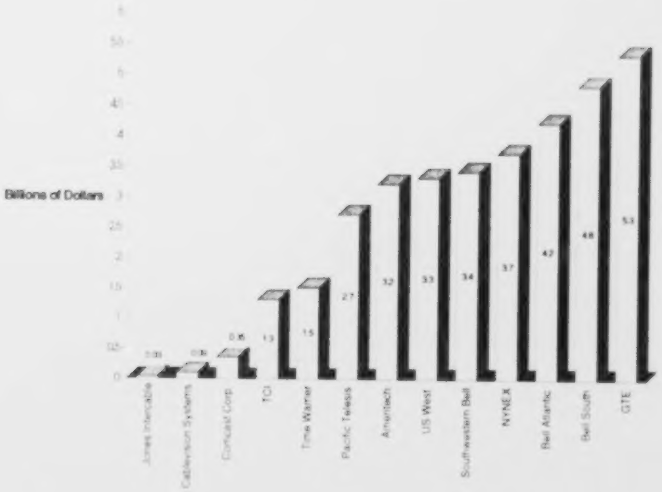
CABLE AND TELEPHONE COMPANY 1993 CASH FLOWS



Source: Telecommunications: Financial Information on 16 Telephone and Cable Companies, U.S. General Accounting Office, July, 1994, p.14. Note that this chart represents the total cash flow of Time Warner, Inc. However, only about 15 percent of Time Warner's annual revenues are from cable sources.

4. MARKET DOMINANCE OF DIVERSIFIED BUSINESSES

Where local telephone companies have been allowed to diversify into businesses that allow them to leverage their local core monopolies, they have moved swiftly to capture a dominant share of the market, foreclosing the benefits of any significant competition.

For example, RBOCs and other local telephone companies now control 65 percent of the cellular licenses in the top 20 U.S. markets. Eight years ago, non-telephone company providers served 50 percent of those markets. In one-third of the top 20 U.S. markets, RBOCs or GTE control both major cellular franchises.

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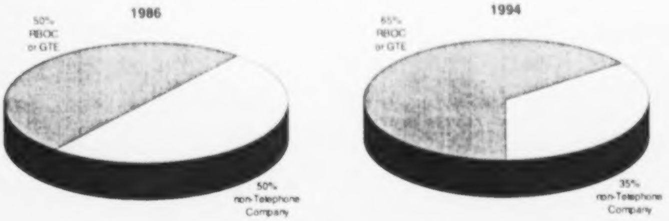
CELLULAR LICENSE DOMINANCE IN THE TOP 20 U.S. MARKETS, 1986 AND 1994



Source: Donaldson, Lufkin, Jenrette, *The Wireless Communications Industry*, Summer 1994, pp. 59, 60

MARKETS WHERE RBOCs OR GTE CONTROL BOTH MAJOR CELLULAR FRANCHISES

Market	Market Rank
Chicago	3
Boston	7
Washington, DC	10
St. Louis	15
Baltimore	16
Phoenix	17

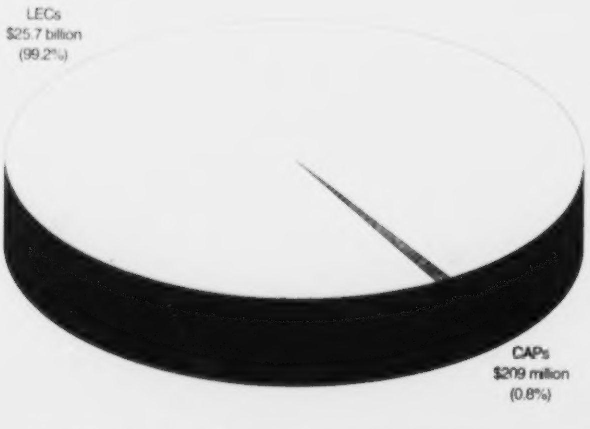
Source: Donaldson, Lufkin, Jenrette, *The Wireless Communications Industry*, Summer 1994, pp. 59, 60

5. LOCAL COMPETITION

Local telephone companies claim that competition in the local loop for voice services is pervasive and not only threatens their core business, but jeopardizes their ability to provide universal service. In reality, the so-called "competition" to local telcos is so minuscule as to be virtually irrelevant.

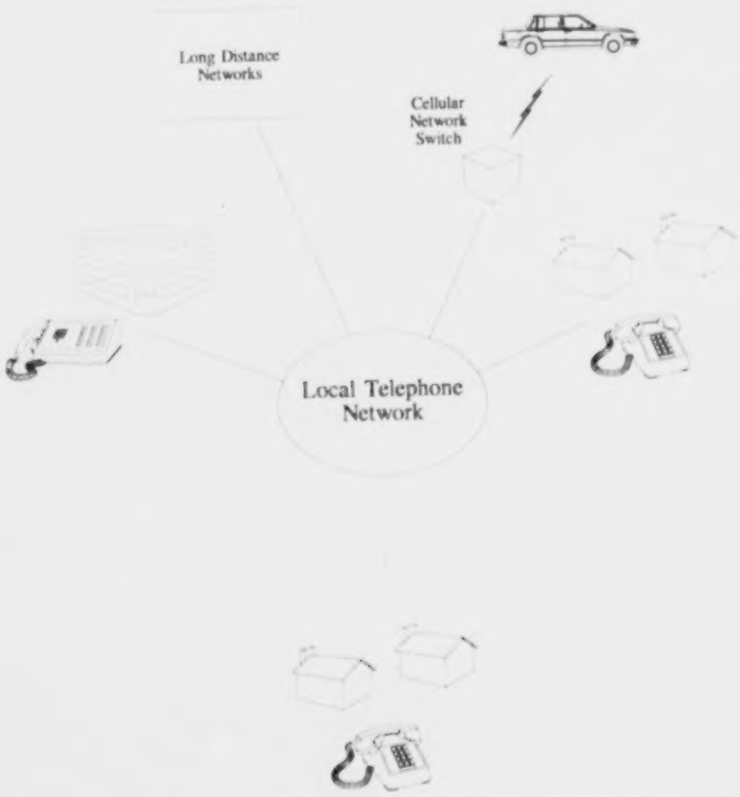
For example, competitors for the network access portion of the local exchange market (i.e., access to long distance services such as AT&T and MCI) have garnered less than 1 percent of that market. At the same time, RBOCs have installed thirty times as much fiber optic cable as their competitors who provide access services. **For the residential user, there is still no practical alternative to the local telephone company for local telephone service**.

NETWORK ACCESS REVENUE, 1993



Source: Economics and Technology, Inc. and Hatfield Associates, *The Enduring Bottleneck*, February 1994, p 2.

"The Local Network is Almost the Only Telephone Market Today that Continues to be Dominated by a Single Provider"
– Reed Hundt, Chairman, FCC, Feb. 12, 1994

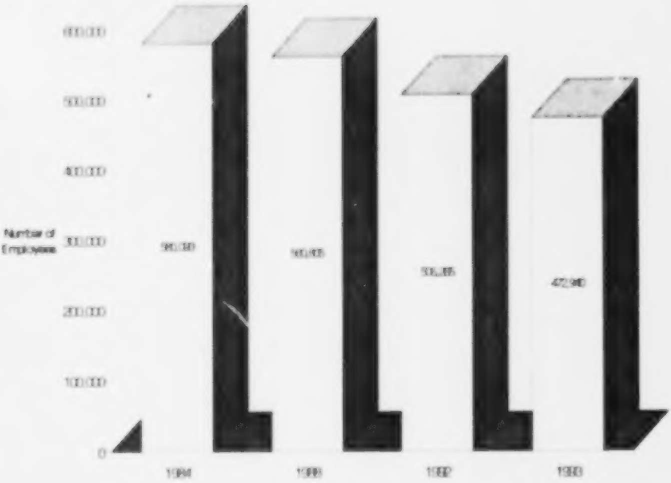

Long Distance Networks
Cellular Network Switch
Local Telephone Network

Source: As cited in the testimony of Robert Allen, Chairman, AT&T, before the Senate Committee on Commerce, Science & Transportation, May 12, 1994, p. 4

6. ECONOMIC IMPACT

The alleged economic benefits of eliminating restrictions on which businesses local telephone companies may enter are illusory. The record shows that in recent years there have been no net jobs created by RBOC diversification. In fact, local telephone companies have cut employment by 18.5 percent since 1984, a period in which the RBOCs amassed nearly $66 billion in profits.

RBOC EMPLOYMENT



Source: RBOC Annual Reports; *MIS Week*, January 2, 1989, p. 18

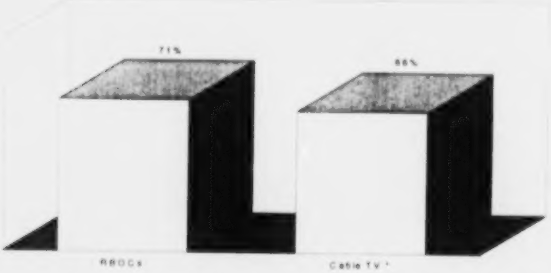
RBOC JOB SLASHING ACCELERATES

Date	Company	Jobs cut
1992	Bell South	8,000
1993	NYNEX	22,000
	Bell South	2,200
	US West	9,000
	Southwestern Bell	1,500
	Ameritech	1,500
1994	Pacific Telesis	10,000
	NYNEX	16,800
	Ameritech	6,000
	Bell Atlantic	5,600
	US West	1,000

Source: Kathryn Jones, "Bell Atlantic Joining a Cutting Trend," *New York Times*, August 16, 1994, at D1, D4. "US West Cutting Jobs in Oregon," *Associated Press*, August 24, 1994, available on Prodigy, Company News file.

Although the cable television industry is significantly smaller than the RBOCs, its commitment to capital expenditures is on par with that of the RBOCs, as the following chart demonstrates:

1993 CAPITAL EXPENDITURES AS A PERCENTAGE OF CASH FLOW



Source: *Telecommunications, Financial Information on 16 Telephone and Cable Companies*, U.S. General Accounting Office, July 1994, p. 14. * This figure includes the largest 5 publicly held cable TV companies only.

B. DBS OFFERS SIGNIFICANT COMPETITION TO THE CABLE TV INDUSTRY

In addition to the phone companies, which are entering the cable business through the courts and the video dialtone proceedings at the FCC, cable companies now face competition from DBS – Direct Broadcast Satellite. DBS companies offer multichannel video service directly to consumers via a small satellite receiving dish about 18 inches wide. DBS services that deliver up to 150 channels of traditional cable programming and pay-per-view movies are now available to every home in the continental U.S. Consumers can easily purchase DBS satellite dishes through retail outlets across the nation, including Circuit City, Sears, Montgomery Ward's, and companies participating through the National Rural Telecommunications Cooperative (NRTC).

1. DBS services are growing rapidly

DBS clearly represents a significant new form of competition to the cable television industry. In June 1994, two DBS service providers unaffiliated with the cable industry[4] began selling video programming in 23 states. **DirecTV**, a unit of GM/Hughes Electronics, has two DBS satellites in orbit and offers home-viewers program packages containing 40 cable networks, 40 to 50 pay-per-view movies, 20 channels of a-la-carte programming, and 30 channels of digital audio recordings. Subscription prices range from $5.95 to $21.95 per month; pay-per-view movies cost $2.99. **USSB** (United States Satellite Broadcasting, a division of Hubbard Broadcasting), offers home viewers program packages of 30 cable channels, including basic services and multiple versions of HBO, Showtime, The Movie Channel, and Cinemax. Subscription prices range from $7.95 to $34.95 per month. In addition, DBS offers exclusive events such as NBA games which are not available on cable.

Analysts predict that DBS will be one of the fastest introductions ever of a new consumer electronics product. Within months of its launch, DirecTV and USSB attracted more than 100,000 customers. At the end of 1994, USSB and DirecTV reported adding some 2,000 new subscribers a day.[5] It is estimated that non-cable-affiliated DBS companies will have approximately 2.2 million subscribers by the end of this year, and 5.1 million by the year 2000 – an increase of more than 130 percent in just five years.[6] If DBS attracts 3 million or more subscribers by the end of 1996 as expected, it will be among the top five multichannel video distributors in the U.S. and will be larger than most cable companies.

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[4] A consortium of cable companies owns Primestar, a direct-to-home satellite service that has approximately 600,000 customers nationwide. Primestar currently does not use the small high-powered dishes used by DirecTV and USSB, but rather a medium-sized dish.

[5] *The Atlanta Journal and Constitution*, November 6, 1994.

[6] Paul Kagan Associates, *Cable TV Investor*, May 18, 1994.

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2. DBS companies are large and aggressively marketing their services

DBS companies are run by well-funded major U.S. corporations and can be expected to remain viable in the long term. For example, DirecTV's parent company, GM/Hughes Electronics, has annual revenues of approximately $14 billion and has already committed $700 million to DirecTV over the past decade; it is rolling out DirecTV with a $50 million advertising campaign.[7] In total, DBS service providers have budgeted $110 million for advertising in 1995.[8]

3. DBS is attracting a wide range of customers, including those in areas served by cable

The DBS advertising campaigns are producing results. Half of DBS subscribers are from urban areas already passed by cable, according to DirecTV's initial findings of their new subscribers.[9] Moreover, USSB's initial research shows that in any given market, the profile of USSB subscribers matches the general demographic makeup of that market.[10] As such, DBS subscribers do not appear to be drawn from any particular demographic group and represent a loss of actual and potential cable customers across the nation.

4. The cost of DBS satellite dishes is expected to decline quickly

Although dishes currently cost approximately $700, RCA/Thomson -- currently the sole manufactorer -- will soon face competition. The result of this competition will be rapidly declining dish prices. For example, Sony is licensed to begin production when RCA has sold one million units, which is expected to occur as early as May 1995. Just last week, DirecTV announced that it would license additional manufacturers (Uniden, Toshiba and Hughes Network Systems), who will start to sell their systems in early 1996.

Dish prices are expected to drop significantly because, as recent history shows, the prices of consumer electronics decline dramatically shortly after their introduction. For example, the average real prices of cellular telephones declined 55 percent in only two years. Similarly, the average real price of videocassette recorders declined 35 percent in only two years. With declining equipment costs, the rate of DBS subscriptions nationwide will accelerate, increasing the level of competition to the cable industry. At last week's Satellite Broadcasting and Communications Association's meeting in Las Vegas, press reports indicated that prices for individual dishes would drop to approximately $399 in 1996.[11]

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[7] *The Washington Post*, December 28, 1994.

[8] *Electronic Media*, January 16, 1995.

[9] *Daily Variety*, December 20, 1994.

[10] *Mediaweek*, October 3, 1994.

[11] *CableFAX*, March 15, 1995.

5. DBS has mandatory, legal access to cable programming while no similar rights are available to cable providers

DBS providers deliver virtually every program network offered on cable, including movies, sports, and dozens of channels of pay-per-view movies. They are assured access to cable programming through the Cable Act of 1992. DBS providers are also developing exclusive programming. For example, DirecTV has contracted with the National Basketball Association to offer 400 NBA games this season and approximately 700 games next season. The cable industry has no similar program exclusivity rights, nor does it have mandated access to programming developed by DBS companies or telephone companies.

6. The multichannel video market will grow increasingly competitive

Additional DBS competitors are expected to offer their services in the near future. EchoStar expects to launch the first of two satellites and begin a competing DBS service in November 1995. In addition to high powered DBS competition such as DirecTV, cable also faces such competition from over four million low-power C-band dishes nationwide.[12] Finally, wireless cable providers (MMDS) currently serve about 600,000 subscribers across the country. Subscribership is expected to increase 158 percent in the next two years to 1.5 million, and to 3.4 million by the year 2000.[13] All of these satellite and microwave competitors, combined with the entry of the telephone companies into the video business, indicate a vibrant, competitive television marketplace.

III. RATE REGULATION HAS HAD SEVERAL NEGATIVE, UNINTENDED CONSEQUENCES FOR THE CABLE INDUSTRY

Despite some assertions that the FCC's rate regulations have not harmed the cable industry, there are data which show that federal rules have had a significant impact on cable companies. For example:

- Cable television industry revenues were flat in 1994 -- the first time ever that the industry's revenues have not grown from one year to the next. According to estimates by Paul Kagan Associates, total annual revenue for the industry will be $23.012 billion in 1994 versus $23.021 billion in 1993.

- Many cable companies suffered substantial earnings losses in the third quarter of 1994. For example, TCI's cash flow was $437 million during the quarter, a nearly six percent decline from the same quarter a year earlier. Similarly, Time Warner's cash flow decreased nine percent. Indeed, for the first nine months of 1994, Time Warner Cable's cash flow decreased six percent from the same period a year earlier. Another major cable company, Cablevision Systems, also saw declines in the third quarter of 1994.

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[12] Satellite Broadcasting and Communications Association.

[13] Paul Kagan Associates, *Wireless Cable Investor*, October 24, 1994.

- The FCC's first rate cuts were in September 1993; deeper cuts did not go into effect until mid-1994. Therefore, the initial impact of the FCC's regulations on the industry's finances will not show up until the full year 1994 financial data are reported. The full annual impact of both cuts will not be clear until the 1995 data are reported.

- While it has been suggested that FCC-mandated rate reductions have stimulated the growth in the number of cable television customers, in fact, the rate of growth has actually declined. According to data published by the independent media research firm of A.C. Nielsen, the rate of growth in the number of customers between February 1994 and February 1995 was 2.85 percent as compared to 3.14 percent a year earlier.

- The cable television industry's ability to obtain financing to fund necessary investments in plant, equipment and programming has also suffered as a result of the FCC's regulation. According to a recent, independent analysis by The Economics Resource Group, Inc.[14] risks to investors in cable companies have increased due to regulatory uncertainties created by the FCC and constraints on operating flexibility created by reregulation, among other factors. These risks have slowed the flows of capital to domestic cable companies which has, in turn, delayed capital expenditure programs and discouraged investments in programming.

- According to the same Economics Resource Group analysis, these negative investment effects are likely to be most severe among small and medium-sized firms in rural markets because such systems have disproportionately high regulatory burdens and low permissible rates. (There are nearly 1,700 small and rural cable companies that serve about 30 million customers in the U.S.)

- The FCC's rate regulations have slowed the growth in cable television programming. In particular, the substantial uncertainty created by the FCC's "going forward" rules had a dramatic impact during the first half of 1994 – virtually halting any increase in the number of households reached by basic cable networks.

- Although the FCC's recently-released "going forward" rules may have helped some cable networks, the rules "are largely a non-event"[15] for new networks and reportedly "may actually have been harmful" because they "relegate many of the start-ups into a-la-carte packages or new product tiers." Indeed, Americana Television Network, which began operation in 1994 but went dark, has been referred to as a "casualty of the FCC's going forward rules."[16] At least a dozen other start-up services have postponed their launch dates, including The Health Channel, Talk TV Network, The Military Channel, Parenting Satellite Television, The Technology Channel, and the Arts & Antiques Network.

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[14] William M. Emmons, Adam B. Jaffe and Jonathan Taylor, *The Investment Consequences of the Re-regulation of Cable Television*, The Economics Resource Group, December 20, 1994.

[15] Paul Kagan Associates, Cable TV Programming, January 19, 1995, p. 1.

- Cable operators have seen the value of their stock diminish greatly since September 1993, the time of the FCC's first rate cuts. As tracked by Paul Kagan Associates, **the value of cable operator stocks dropped six percent between September 1993 and February 1995, as compared to the S&P 500 index and the NASDAQ composite, which rose six and seven percent respectively during the same period.**

A perverse result of cable reregulation is that American cable companies are now investing their money overseas instead of at home – a phenomenon that runs counter to the Administration's stated goal of accelerating deployment of a National Information Infrastructure. As one trade publication observed, "No major American MSO completed an initial public offering during 1994, although several U.K. operators did market public equity successfully."[17] Christopher Dixon, an industry analyst at PaineWebber, concluded, "You won't see any capital move into the U.S. cable industry until the regulatory environment clears. Ironically, the opportunities outside the U.S. where regulation is much more benign is where investors are starting to look."[18]

IV. THE EFFECTIVE COMPETITION TEST FOR CABLE TELEVISION SHOULD BE CHANGED

Cable television companies are the most likely competitors to local phone monopolies. They have the technology and expertise necessary to compete with the telcos but face challenges from DBS as well as regulatory, legal, and financial obstacles which place them at a competitive disadvantage. Most notably, many cable companies are finding it difficult to obtain the billions of dollars needed over the next five years to upgrade their headends, finish installing fiber, and expand their use of digital compression technology.

While investors have enthusiastically supported cable's expansion in the past, they are now reluctant to assist the industry's efforts to build competitive telecommunications systems. Investors lack the confidence they need to provide loans to the cable industry since the FCC's costly, complex, and constantly changing regulations on the pricing, packaging, and marketing of cable services remain in full effect until cable companies lose a crippling 15 percent of their market share. By contrast, the larger, richer phone companies enjoy much easier access to capital than their would-be competitors, the cable industry.

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[16] *Broadcasting and Cable*, November 21, 1994, p. 24.

[17] *Public Financing Lags As Banks Re-Enter The Fold*, CableTV Finance, December 30, 1994.

[18] Jeffrey Daniels, *$10 billion cable bill in wake of FCC rollbacks*, The Hollywood Reporter, May 5, 1994.

The current statutory definition of effective competition should be modified to reflect changes in the competitive landscape over the last three years. As outlined above, DBS services are already competing directly with cable TV companies. Moreover, when Congress reregulated cable rates in 1992, it also preserved the 1984 law barring phone companies from competing with cable in video services. But now the courts have lifted the cross-ownership ban for the RBOCs, GTE, and all other members of USTA (except Southwestern Bell and SNET). Phone companies have also received approval to deliver video services directly to consumers through video dialtone facilities, and many more VDT proposals are pending. Indeed, Congress seems poised to allow telephone companies to enter the cable business in the very near future. Legislation that recognizes marketplace changes and refines cable rate regulation will permit cable companies to compete with the phone companies for access to capital – and to compete with them in the provision of advanced telecommunications services.

A. THE DEFINITION OF EFFECTIVE COMPETITION TODAY

Cable television companies today are regulated by federal law. The Cable Act of 1992 specifies that cable rates are subject to FCC regulation unless the cable company faces "effective competition" – which requires satisfying two tests: (1) At least 50 percent of the homes in the franchise area must have access to a second multichannel video provider; and (2) At least 15 percent of the homes in the franchise area must purchase multichannel video service from an alternative provider.

The FCC has determined that today, only 40 to 50 communities nationwide meet this standard of effective competition. Cable companies that serve the remaining 30,000 U.S. communities are subject to lengthy and complex regulations at both the federal and local level.

B. MARKET CONDITIONS HAVE CHANGED

The effective competition standard for cable television was developed at a time when the 1984 Cable Act's telco-cable cross ownership restrictions were in full effect. Since then, telephone companies have been moving aggressively to enter video markets through regulatory applications, court proceedings, and legislative action. Furthermore, cable faced no competition from DBS when the Cable Acts of 1984 and 1992 were signed into law. As noted previously in this testimony, several DBS services are now available to consumers.

The RBOCs and other local telephone companies have developed plans to deliver multichannel video services to consumers via wire-based "video dialtone" (VDT) facilities. The FCC has begun to approve VDT applications: as of January 1995, local phone companies were authorized to deliver VDT services to over 1.5 million homes. Video dialtone poses an enormous competitive threat to cable companies, particularly in view of the telephone industry's ready access to capital, tremendous market power, and ubiquitous access to telephone consumers.

Moreover, Congress is contemplating legislation that will allow the local telephone companies to program and deliver video services themselves – in essence, to act as cable operators. At the same time, Federal courts have struck down the Cable Act's telco-cable cross ownership ban for six of the seven Bell operating companies and GTE. These legislative and legal measures will ultimately unleash extraordinarily powerful competitors to the cable television industry.

C. PROBLEMS WITH THE CURRENT DEFINITION OF EFFECTIVE COMPETITION

The current definition of effective competition to cable is flawed in at least two important ways:

- It restricts the ability of the cable industry to respond to competitive pressures until individual cable companies lose 15 percent of their market share.
- It improperly emphasizes the loss of market share over the price-constraining presence of actual and potential competitors such as DBS and the telephone companies.

Moreover, cable systems today are hobbled by a host of local and federal regulatory burdens that prevent them from responding to competitive challenges. These regulatory burdens take a number of forms, including the following:

1. Excessive costs

In an environment where no effective competition exists, rate regulation may confer benefits on consumers that outweigh the costs, delays, and inefficiency imposed by regulation. But if effective competition does exist, rate regulation serves no other purpose than to impose costs and constraints on cable to the benefit of cable's competitors.

Regulatory lags make service offerings inflexible. The current definition of effective competition would retain cable regulation long past the point where it is even necessary, thus preventing cable from responding to consumer demand and marketplace changes. Aside from the huge expense of complying with regulations, cable systems must cope with local and federal government review of nearly each action the cable system takes.

Under current regulations, a cable system's decisions regarding pricing or channel offerings are often subject to regulatory review and approval – whether those decisions involve increasing prices, decreasing prices, or adding, deleting, or repackaging channels. Each of the nation's 13,000 cable systems face not only second-guessing by regulators, but regulatory delays of 30 to 120 days or longer.

Regulatory lags and micro-management impede every cable system's ability to quickly respond – or to respond at all – to the actions of their competitors. Competitors will be free to change packages and prices, while cable operators' packages and rates are fixed by statute and regulation.

Regulations limit the investments needed for competition. As discussed in section III above, many cable companies have suffered substantial setbacks in cash flow as a consequence of rate regulation. The FCC's implementation of the Cable Act of 1992 has increased risks to investors in cable companies, delayed capital expenditures, and discouraged investments in programming.[19]

2. Inappropriate emphasis on loss of market share

The Cable Act's effective competition standard demands that cable's competitors capture, community-by-community, 15 percent of the multichannel video market before federal regulators legally can deem an alternative provider a true "competitor" to cable television. In reality, however, cable companies will respond to competitive pressures brought by any credible alternative provider – actual or potential – whose ability to compete with them constrains their ability to raise cable prices. Indeed, a long and well-established body of antitrust and economic literature maintains that prices are constrained by the ability of new firms to enter the market. In the case of cable television, of course, DBS providers are **already** offering competing services.

In addition, the market-by-market measure of effective competition leads to a paradox: cable's competitors will gain the most market share where cable service is least satisfactory or most expensive; leaving cable operators with the best service and lowest prices regulated longer than those with higher prices and mediocre service.

3. The need to redefine effective competition

The definition of effective competition for cable television is flawed and places the cable industry at a competitive disadvantage vis-à-vis the telephone companies. These flaws have grown particularly evident with the emergence of strong competition to cable television, such as DBS. The definition of effective competition for cable television should be revised so that cable companies can respond to these competitive pressures. The new definition should rely not on an arbitrary measure of market share, but rather on the ability of credible competitors to enter the television market and compete with cable operators. In the case of telephone companies, the authorization of their entry into video is sufficient to warrant deregulation of the cable industry's upper service tiers.

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[19] William M. Emmons, Adam B. Jaffe and Jonathan Taylor, *The Investment Consequences of the Reregulation of Cable Television*, The Economics Resource Group, December 20, 1994.

VI. CONCLUSION

The cable industry endorses the passage early this year of telecommunications reform legislation. The time has come for Congress to take back telecommunications policy from the courts and update the Communications Act of 1934. The problem for both Congress and the cable industry is that there is a fundamental imbalance in the video market: competition has arrived for cable in the form of DBS, MMDS, and telephone company entry into cable before the telephone companies have had to open up their local exchanges. At the same time that the federal courts are allowing RBOCs into television and the FCC is allowing telcos to provide video dialtone, state and local barriers and an intrusive regulatory regime prevent the cable industry from competing in the provision of local telephone service. Congress needs to rectify this regulatory imbalance and establish new groundrules for fair competition.

APPENDIX A

DETAILS ON NCTA'S TELECOMMUNICATIONS POLICY POSITIONS

A. ELIMINATE STATE AND LOCAL BARRIERS TO COMPETITION

NCTA believes that Congress should (1) eliminate state, county, and city barriers to competition in the market for local phone service, and (2) prohibit the imposition of new state and local barriers to competition. The reason is simple: Over 99 percent of all telephone calls are routed through the local telephone "loop" -- the phone wires that connect telephone users to the phone company's central office. This monopoly on phone service is typically protected by a myriad of state and local regulations that bar competition in the market for local phone service. Today only 10 states have taken measures to open up local phone service to competition. In the remaining 40 states, state and local barriers to competition remain unchanged, thereby impeding the development of competition (see Appendix B for a state-by-state summary).

Competition in the local loop will not emerge this century -- if at all -- if potential competitors are forced to fight regulatory barriers in each of forty states. Congress' removal of entry barriers is a key ingredient in the formula for introducing choice to consumers of telecommunications services. Even in those states where barriers to competition have been lifted, local telephone companies continue to pursue legal challenges that further delay the introduction of competition. If the information superhighway is to become truly seamless and serve all Americans, potential competitors must be able to enter the marketplace on a national basis.

B. ENSURE COMPETITION BY ESTABLISHING CONDITIONS FOR TELCO ENTRY INTO NEW LINES OF BUSINESS SUCH AS VIDEO

Local exchange companies developed over the past 100 years as monopoly providers of telephone service and still handle 99 percent of all local telephone calls. The Regional Bell Operating Companies alone enjoy annual revenues of $85 billion as compared with $23 billion for the cable industry, $27 billion for broadcasting, and $45 billion for newspaper publishing. Local exchange companies have the power to limit competition, even in markets where they are no longer legal monopolies, by restricting access to their networks and their consumers.

A key question before Congress is how best to introduce competition into local exchange markets dominated by telephone company monopolies. The answer is that Congress should condition the telephone companies' entry into new lines of business on their willingness to open up the local loop to competition. **Before allowing local telephone monopolies into**

new lines of business, Congress must establish conditions that will guarantee the ability of new entrants to compete with them in the provision of local telephone service. These conditions include the unbundling of the telephone companies' networks and services; interconnection; access to poles and conduits; number portability; dialing parity; and fair compensation for call termination.

Ensuring viable competition is the best safeguard against predatory behavior and unfair pricing by local telephone companies. As such, the Federal Communications Commission should make an affirmative ruling that the following conditions have been met before allowing telephone companies into video:

- **Interconnection:** Since new competitors will not be able to duplicate the existing telephone network's reach, competitors should be allowed to interconnect their facilities with the telephone company's, thus guaranteeing customers access to both networks.

- **Compensation:** Charges for terminating a call on the incumbent telephone company's network should be fair and not place new service providers at a competitive disadvantage.

- **Unbundling:** In order to foster competition, regulators must require telephone companies to "unbundle" their services, i.e., separate the various features of their networks (such as switching, billing, and access to individual homes) and offer them to all comers under equal prices, terms, and conditions.

- **Collocation:** In order to interconnect with telephone networks, competitors need to be able to locate their lines and equipment in the telephone companies' central offices.

- **Access to poles and conduits:** Historically, telephone companies have discriminated against cable companies by denying them access to poles and conduits. It is crucial that cable companies be allowed to use the telephone companies' facilities to provide telecommunications services for a fair fee.

- **Number Portability:** Consumers should be allowed to keep their telephone numbers and carry them from one network to another when changing telecommunications providers.

- **Dialing Parity:** Consumers should be able to dial the same number of digits to reach a telephone number no matter whose network they use (some telephone companies are suggesting that people using a competitor's network should have to dial a longer number to reach one of their customers).

- **Resale:** There should be no restrictions on the resale or sharing of telecommunications services, including local telephone service.

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C. AVOID INCREASED REGULATION OF TELECOMMUNICATIONS SERVICES AT THE CITY LEVEL

Some cities argue that they should be given expanded authority to regulate non-video communications services offered by cable companies such as telephone service, wireless communications, and multi-media applications. They have also suggested that Congress should expand their existing authority under the Cable Act to assess a five percent franchise fee on cable television revenues to cover these new services. Congress has historically rejected these appeals as an unwarranted intrusion by local government on interstate commerce and the imposition of an unnecessary layer of bureaucracy on the national information infrastructure.

Cities should not be allowed to regulate or tax new competitive telecommunications services offered by cable companies. Regulation of tele-communications services is already handled by state PUCs and the FCC. It would be a mistake to expand the cities' existing regulatory authority over cable franchises to include telephone, PCS, or any other telecommunications service.

(1) Cities already have adequate control over local cable franchisees

Cities already collect franchise fees from cable operators for video services and control access to public rights of way. The Cable Act allows cities to tax up to five percent of all cable company video services revenues. In 1994 this amount exceeded $1 billion.

Moreover, cities have existing authority to regulate "street cuts," whereby telephone companies, utilities, and cable companies dig up public rights-of-way only with the permission of local authorities. Telecommunications reform legislation need not take away any existing municipal jurisdiction over cable franchises or street cuts. Rather, it should merely prevent cities from unwarranted expansion of their regulatory authority over new telecommunications services.

(2) Cities have a long history of abusing rate setting powers

City councils are political bodies, not quasi-judicial agencies. They lack the personnel, economic resources, or knowledge required to administer national telecommunications networks. Before the 1984 Cable Act, cities abused their rate-making authority to extract concessions from cable franchisees that had nothing to do with the provision of cable service, e.g., funding for parks and public works.

Recently, local franchising authorities have attempted to expand their authority over the provision of cable service to include telecommunications services offered by cable operators.

In some cases, franchising authorities have conditioned the renewal of cable franchises on agreements by cable operators to construct new telecommunications networks in addition to upgrading their existing video facilities.

(3) Cities would raise the cost of new services by subjecting them to franchise fees

Franchising authorities have already sought to collect franchise fees – statutorily authorized in connection with the offering of cable service – on the basis of revenues that cable operators earn from providing telecommunications services. Absent a clear statutory prohibition on such efforts, these instances are likely to increase as more cable operators upgrade their cable facilities and offer telecommunications services other than video.

(4) Cities would slow the development of a national information infrastructure

Local regulation of telecommunications services offered by cable operators would undermine the public interest by subjecting cable operators to multiple and inconsistent regulations. Under the cities' proposal, cable's telecommunications services would be regulated by three levels of bureaucracy – federal, state, and local.

Local governments have not historically regulated intrastate telecommunications services. The "Balkanization" of regulatory authority over intrastate telecommunications services that would result from local regulation of such services would frustrate the rapid growth and development of a robust telecommunications infrastructure.

The cable industry does not seek to restrict a franchising authority's legitimate exercise of its authority over the franchising or provision of cable service as established in Title VI, including the collection of franchise fees based on cable revenues. However, we believe that the state public utility commissions, which are generally responsible for the regulation of intrastate telecommunications, are better equipped than cities to exercise authority over a cable operator's intrastate telecommunications facilities and services.

D. ALLOW FLEXIBILITY FOR MERGERS AND JOINT VENTURES

Pro-competitive telecommunications legislation is appropriately based upon an economic model in which several providers compete to deliver telecommunications services to consumers. Under present law, local telephone companies are permitted to engage in mergers and joint ventures with cable companies outside their own telephone service territories.

In many markets, two wires will be available to consumers, who will be able to choose between competing providers. However, it is unrealistic to expect that all markets in the U.S.

will be able to sustain competing broadband facilities, particularly in light of developing competition from wireless and DBS services. Consequently, policy makers must determine how to encourage the development of advanced telecommunications facilities in areas whose economies cannot support more than one wire. Allowances for mergers and joint ventures are essential in order to promote the availability of advanced telecommunications services to all Americans.

Telecommunications law should permit joint ventures between cable and telephone companies, and allow mergers in low-density and rural markets that are unlikely to support two-wire competition, for three reasons:

(1) An outright ban on mergers and joint ventures will diminish the widespread availability of advanced communications services. Rural areas and smaller markets might not support the independent construction of advanced information infrastructures by cable or telephone companies.

(2) In such areas where side-by-side communications networks could not be expected to exist, cable and telephone companies may still be able to introduce advanced communications services by pooling their resources in a regulated environment.

(3) Antitrust laws allow joint ventures or mergers to occur when they do not create monopolies or lessen competition, and recognize that such transactions produce consumer benefits that would not otherwise materialize.

E. TREAT RURAL TELECOMMUNICATIONS COMPANIES EQUALLY

Telecommunications legislation offered in the House and Senate during the 103rd Congress presented severe inequities for rural cable operators. S. 1822 and H.R. 3626 included exemptions that would have allowed rural telephone companies to offer cable service without opening up their networks for interconnection with competitors – meaning, as a practical matter, that rural telcos would be shielded from competition. The Senate bill, S. 1822, created further competitive disparities between rural cable and telephone companies. Specifically, S. 1822 authorized state-imposed barriers that would have protected rural telcos from local competition while permitting them to enter the cable business.

New telecommunications reform legislation should not disadvantage rural cable companies, but should treat all rural businesses equally. **Interconnection and equal access obligations should apply uniformly to all telcos, including rural telcos, seeking to provide cable service. Rural telcos, like other telephone companies, should be in compliance with these obligations before they begin providing cable service. If rural cable operators effectively are barred from entering the telephone business, then rural telcos should likewise be precluded from entering the cable business.**

Pursuing the approach taken in last year's legislation would raise the following problems:

(1) Exemptions for rural telcos from interconnection and equal access obligations create insurmountable obstacles to the development of competition. To ensure competitive parity, rural telcos must open up their networks to competition before they enter the cable business.

(2) State-imposed entry barriers hobble and unfairly penalize rural cable operators in their efforts to compete, while protecting the rural telcos' local telephone monopoly.

(3) If rural telcos are concerned that interconnection and other requirements would be too costly and burdensome, then those telcos clearly are not equipped to enter the video market. Likewise, if those telcos are capable of entering the video market, then they would certainly be able to meet the requirements of interconnection and other pro-competitive conditions.

(4) The net effect of proposals to exempt rural telcos from interconnection and equal access obligations, to authorize state-imposed barriers to local competition, and to allow rural telcos into the cable business in rural areas create significant competitive disparities for rural cable operators. Such proposals deny rural cable operators access to capital needed to improve their networks and remove any incentives other companies may have to develop alliances, leaving rural cable operators with few, if any, strategies to compete and survive.

(5) Notwithstanding the impact such barriers and exemptions have on rural cable operators, rural telcos have argued that state-imposed barriers to competitive entry are necessary because of the threat such entry poses to universal service. Rather than preserving universal service, such barriers serve primarily to shelter the rural telcos from local competition.

F. GUARANTEE UNIVERSAL SERVICE

Basic telephone service is an essential service, and subsidies may be necessary to ensure that it remains affordable to low income and rural customers. Regulators established a "universal service fund" in the aftermath of AT&T's divestiture in order to make sure that the support of affordable phone service was equitably distributed among all long distance companies. A similar model has been proposed for a competitive local telephone marketplace.

In a competitive marketplace, cable companies and others who become providers of telecommunications services have a corresponding responsibility to contribute to the maintenance of universal service. The cable industry understands and accepts this responsibility: it recognizes the vital importance of ensuring universal basic telephone

service and is prepared, as cable companies begin to offer telephone services, to pay a proportionate share of any subsidies required to meet this goal. It is important, however, that all providers that are willing to deliver universal service should have access to the subsidy fund to which they contribute.

Local competition will promote universal service policies by driving down prices and affording consumers greater choice among providers. The universal service provisos of new telecommunications legislation should:

(1) Require that competitors in the local telecommunications market, to the extent necessary, pay a fair share of the cost of universal service;

(2) Make universal service subsidy funds available to any provider that is willing to deliver universal service;

(3) Define universal service as basic touch tone service, and permit later redefinition if it is made necessary by the market-based adoption of additional services.

(4) Require that the amount necessary to support universal service be carefully calculated to avoid imposing unnecessary burdens on consumers and jeopardizing the growth of competition.

G. ENSURE FAIR POLE ATTACHMENT RATES

The Pole Attachment Act of 1978 recognizes that cable attachments occupy the excess space on a pole and establishes an appropriate formula for pricing pole attachment rights. Under present law, utilities are permitted to charge cable operators a share of all the direct and indirect costs that the utilities incur to install and maintain the entire pole.

The share of those common costs cable operators pay is based, quite logically, on the percentage of usable pole space occupied by them – typically about one foot of pole space. There are usually 13.5 feet of usable space on a pole and only one foot of that is used by cable operators. FCC regulations require a cable operator to pay seven and a half percent of the utility's total costs for each pole used. Therefore, cable operators pay a **proportional share** of the costs of the non-usable space on a pole as well as the usable space.

In 1993 the Federal Appeals Court affirmed an FCC decision to apply the standards of the Pole Attachment Act to attachments used by cable operators for both video and other telecommunications services. However, the electric utilities are advancing a proposal to require that cable operators delivering telecommunications services be required to pay not only a proportionate share of the usable space, but also an **equal** share of the cost of the non-usable space on the pole.

The electric utilities' "equal share" proposal defies established law and marketplace logic. It would harm efforts to deliver advanced telecommunications services, disadvantage rural areas, and deter cable operators from constructing advanced telecommunications services for the following reasons:

(1) An "equal share" formula is comparable to permitting the owner of an office building to charge his sole tenant one-half of the costs of maintaining a building elevator and lobby -- even thought the owner occupies twelve floors of the building the tenant only one floor.

(2) An "equal share" formula would triple the pole attachment expenses of a cable company offering telecommunications services. These extraordinary costs could undermine the economic feasibility of competitive telecommunications services and deter new service providers from constructing advanced telecommunications networks.

(3) The effect of these sharply increased costs would be particularly acute in rural areas, where it takes more poles to reach the same number of customers. These are precisely the areas in which the incentives for infrastructure competition are already the most problematic.

(4) The electric utilities themselves are considering entering the telecommunications business. By imposing these extraordinary costs on telecommunications providers, the utilities may in fact be impeding their potential competitors.

Cable operators should not be required to pay more than a proportional share of the usable and non-usable space for all pole attachments. As such, no change in current law is necessary. If telecommunications legislation addresses pole attachments, cable operators should not be required to pay more than a proportional share of the usable and non-usable space for all pole attachments.

APPENDIX B

STATUS OF LOCAL EXCHANGE COMPETITION IN THE UNITED STATES (1)

Agency	Local Exchange Competition(2) Allowed?	State Law Change Needed for Full Competition?	Comments
Alabama PSC	No	No	**PSC Has Statutory Authority to Authorize Local Competition; Alternate Access Allowed; No Switched Service Initiatives**
Alaska PUC	No	Yes	Section 42.05.221(D) of State Code Requires PUC to Eliminate Competition & "Undesirable" Duplication
Arizona CC	No	Yes	Amendment to State Constitution Probably Required. **Corporation Commission Considering Local Competition Rules**
Arkansas PSC	No	Yes	1984 PSC Order Reaffirmed Exclusive Franchise Requirement; LEC Must Be Certificated Common Carrier. **Draft Telecom Bill to Open Local Exchange & Promote Price Caps Shelved Until Special Session in August 1995.**
California PUC	Partial	No	**1994 Law Permits Cable TV to Apply for PUC Certification to Provide Voice Services When Telco Receives Permission to Provide Video Services; Statute Mandates PUC Rulemaking Prior to Open Competition 1997.**
Colorado PUC	Partial	No	Limited Alternate Access; Switched Basic Local is Exclusive Grant of Monopoly Per PUC Order. **Draft Telecom Bill to Open Local Exchange and Authorize Price Flexibility in the Legislature**
Connecticut DPUC	Yes	No	**1994 Law Allows Local Competition; Three CAPs Have Applied for DPUC Certification**
Delaware PSC	Yes	No	Limited Alternate Access; Local Competition Issues Are Pending at the PSC.
District of Columbia PSC	Partial	Yes	**Limited Alternate Access. In 1994 City Council Introduced Local Competition Bill--For Switched and Non-switched Service Providers.**

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(1) Sources: 1994 *NARUC Report on the Status of Competition in Intrastate Telecommunications (Aug. - 1994)*; State Cable Associations; NASUCA Membership; MFS Intelenet; TCG.

(2) For NARUC Survey, Local Exchange Service Competitors Considered to be Wireline Providers & Resellers.
Bold print indicates new information

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Agency	Local Exchange Competition(2) Allowed?	State Law Change Needed for Full Competition?	Comments
Florida PSC	Partial	Yes	**Very Limited Alternate Access (Non-Switched Between Affiliated Entities Only); Local Competition Issues are Pending at the PSC; Draft Legislation Amending The Public Utilities Act by Opening the Local Exchange and Granting Price Flexibility Under Discussion.**
Georgia PSC	No	Yes	Statutory Prohibition: Legislature Amending Public Utility Act to Open Local Exchange and Promote Price Flexibility.
Hawaii PSC	Partial	Unclear	Very Limited Alternate Access (High Speed Digital Private Line Only)
Idaho PUC	Partial	Yes	Code S62-615-LEC Certificate Provides Exclusive Service Area Franchise for Local Telco. However, PUC Does Not Regulate Entry or Rates for Non-Switched (e.g., Private Line) Services. So Competition for those Services Possible.
Illinois CC	Yes	No	Facilities-based Local Exchange Competition Is Permitted. **MFS & TCG Authorized to Provide Local - Switched Access.**
Indiana URC	Partial	Yes	Limited Alternate Access. LEC Holds Exclusive Service Territory Assignments. Several CAPS Authorized. **Telecom Legislation Withdrawn from Committee.**
Iowa UB	Yes	No	**Board Has Authority to Approve Competition; Recent Application by CAP; Draft Telecom Bill Under Discussion.**
Kansas CC	No	Yes	**Commission Proceedings on Local Competition Issues Pending.**
Kentucky PSC	No	Yes	Local Governing Districts May Grant Exclusive Franchises.
Louisiana PSC	No	No	**PUC May Address Local Competition Issues Without Express Grant of Legislative Authority; Competitive Access Proceeding Pending Before PSC.**
Maine PUC	No	No	**No Statutory Prohibition; PUC Reviewing Rules for Local Competition.**
Maryland PSC	Yes	No	**MFS, TCG and MCI-Metro Authorized to Provide Switched Local Business Service.**
Massachusetts DPU	Yes	No	DPU Authorized Facilities-Based Competition for Local Exchange Service & Resale of Local Business Service. **DPU Investigation of Local Competition Issues.**

(1) Sources: 1994 *NARUC Report on the Status of Competition in Intrastate Telecommunications (Aug. - 1994)*; State Cable Associations; NASUCA Membership; MFS Intelenet TCG.

(2) For NARUC Survey, Local Exchange Service Competitors Considered to be Wireline Providers & Resellers.
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Agency	Local Exchange Competition(2) Allowed?	State Law Change Needed for Full Competition?	Comments
Michigan PSC	Yes	No	**Facilities Based Local Exchange Service Is Allowed by Statute; U.S. Signal Granted Switched Local Service & Co-Carrier Status; TCG, MFS & MCI-Metro Applications Pending.**
Minnesota PUC	Partial	Yes	**Limited Alternate Access; Local Competition & Price Flexibility Bill Introduced.**
Mississippi PSC	No	No	**No Statutory Prohibition; PSC Prohibits Competitive Entry.**
Missouri PSC	Partial	Yes	**1995 Telecom Bill Introduced to Open Local Exchange & Authorize Price Regulation**; Partial Non-Switched Local Service Allowed. Statute Requires a Showing that Providing Local Exchange Service Will be in the "Public Interest."
Montana PSC	Yes	No	PSC Has Power to Approve Local Exchange Competition; no Applications Pending
Nebraska PSC	Partial	No	1986 Statute Deregulated All But Basic Local Exchange. Resale of Local Service Deregulated. One CAP Authorized - Non Switched Local Exchange
Nevada PSC	No	Yes	1993 Law Allows Cable to Offer Telecommunications or Related Services. However, Switched Local Exchange Service is Prohibited. **PSC investigation on Price Flexibility & Competitive Local Exchange and establishment of Universal Service fund.**
New Hampshire PUC	No	Yes	Each Telco Has Exclusive Franchise Territory. MFS Applied for Non-switched Services Between Exchanges.
New Jersey BPU	Partial	No	**No Statutory Prohibition; Limited Alternate Access (High Speed Non-Switched Between Customer Premises);BPU Approved IntraLATA Competition but Not for Basic Switched Local Exchange Service; Governor's Task Force on Competitive Issues.**
New Mexico SCC	Partial	Yes	**Statutory Prohibition for Small Telcos; LECs with less than 100,000 Access Lines Have Exclusive Service Territory; U.S. West Subject to Competition - Per SCC Authorization.**

(1) Sources: 1994 *NARUC Report on the Status of Competition in Intrastate Telecommunications (Aug. - 1994)*; State Cable Associations; NASUCA Membership; MFS Intelenet TCG.

(2) For NARUC Survey, Local Exchange Service Competitors Considered to be Wireline Providers & Resellers.
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Agency	Local Exchange Competition(2) Allowed?	State Law Change Needed for Full Competition?	Comments
New York PSC	Yes	No	Alternate Access Allowed; Provision of Local Loop and Local Transport Services for Certain Customers; Local Switched Access and Resale of Basic Local Service Allowed; **PSC Investigation of Local Competition Issues Pending; Cablevision and Time Warner Applications for Local Competition.**
North Carolina UC	No	Yes	Statutory Prohibition; **Bill Introduced to Open Local Exchange & Authorize Price Regulation.**
North Dakota PSC	Partial	No	Alternate Access Allowed; Authority Granted to Two Private Line Carriers for Interactive TV & Resale of Local Exchange Service; **Bill Introduced to Deregulate Telcos With Less Than 50,000 Access Lines**
Ohio PUC	Partial	No	**Alternate Access Allowed; Time Warner Competitive Local Exchange Service Ruling Expected--First Test of OPUC Authority for Grant of Certificate.**
Oklahoma CC	No	Yes	Statutory Prohibition; Competitor Must Prove Telco Service is Inadequate; **Commission Investigation of Local Competition Issues.**
Oregon PUC	Yes	No	1993 Law Grants PUC Authority Over Basic Local Exchange Service; ELI Granted Private Line Certificate; MFS and Columbia Associates Filed for Local Exchange Services
Pennsylvania PUC	Yes	No	**Alternate Access Allowed; 1993 Law Gives PSC Authority to Grant Local Exchange Competition; PSC Reviewing Certificate Applications by MFS TCG, & MCI-Metro Switched Services.**
Rhode Island PUC	No	No	PUC Authorized to Permit Competition for Non-switched Services; Two CAP Applications Pending
South Carolina PSC	No	No	**State Supreme Court Ruled Municipalities Had No Authority to Provide Cable Services; No Statutory Prohibition for Second Carrier; PSC has Authority to Allow Local Exchange Competition.**
South Dakota PUC	No	Yes	Local Exchange Service Competition Prohibited; **Bill Introduced To Liberalize Rate of Return Regulation and Change Cost of Service Methodology.**

(1) Sources: 1994 *NARUC Report on the Status of Competition in Intrastate Telecommunications (Aug. - 1994)*; State Cable Associations; NASUCA Membership; MFS Intelenet; TCG.

(2) For NARUC Survey, Local Exchange Service Competitors Considered to be Wireline Providers & Resellers.
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Agency	Local Exchange Competition(2) Allowed?	State Law Change Needed for Full Competition?	Comments
Tennessee PSC	No	Yes	**1995 Telecom bills Introduced to Open Local Exchange market & Authorize Price Regulation;** Statute Prohibits New Local Service Certificate Unless Current Facilities are Inadequate; Four CAP Applications and a Local Exchange Rulemaking Are Pending at the PSC.
Texas PUC	Partial	Yes	**1995 Draft Bill Introduced in the Legislature to Open Local Exchange Market & Authorize Price Regulation; MFS Intelenet and MCI Filed For Local Exchange Service** in Limited Areas of the State **MFS to Provide Switched Business Service; Current Law Allows Second Carrier to file for Authorization in an Area if There is No Service or if Service is Inadequate.**
Utah PSC	Yes	Yes	**1995 Telecom Bill Passed In Legislature to Open Local Exchange Market & Authorize Price Regulation;** ELI Recently Filed for Local Exchange Service
Vermont PSB	No	No	One CAP Application for Non-Switched Local Service Approved at the PSB
Virginia SCC	Yes	No	**1995 Law Passed to Open Local Exchange Market and Authorize Commission to Address competition issues; Two CAP Applications Approved by SCC; IntraLATA Competition Investigation Reopened;**
Washington UTC	Yes	No	**State Supreme Court Ruled the WUTC May Not Grant Exclusive Monopolies;** **ELI Petition to Provide Local Switched Intra-Exchange Service Granted;** Telecom Bill Limiting **Equal Access Introduced 1995.**
West Virginia PSC	Partial	No	**No statutory prohibition; PSC Prefers Exclusive Local Exchange Service Franchises; Private line service allowed. No CAPS have applied for authority.**
Wisconsin PSC	Yes	No	**1994 Law Authorizes Local Exchange Competition; PUC Recently Authorized TCG to Provide Local Exchange Services.**
Wyoming	Yes	No	**1995 Telecom Bill Passed That Opens Local Exchange Market & Authorizes Price Regulation.** Limited Alternate Access; Alternative Carrier Petition Granted.

(1) Sources: 1994 *NARUC Report on the Status of Competition in Intrastate Telecommunications (Aug. - 1994)*; State Cable Associations; NASUCA Membership; MFS Intelenet; TCG.

(2) For NARUC Survey, Local Exchange Service Competitors Considered to be Wireline Providers & Resellers.
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The CHAIRMAN. Thank you very much. Mr. Roy Neel, president and CEO, United States Telephone Association.

STATEMENT OF ROY NEEL, PRESIDENT AND CEO, UNITED STATES TELEPHONE ASSOCIATION

Mr. NEEL. Thank you, Mr. Chairman and Senator Hollings. Thank you, both of you, for your leadership on this issue and for continuing this debate this year.

Decker is exactly right. This is about local competition. And it is important as you go through this debate, as you consider whether or not to repeal cable's rate regulation under the 1992 Cable Act, that you understand that it is not an isolated move here; that it does relate to local competition.

In doing so, you provide additional investment incentives, but you also go further in tilting the playing field. Competition is the right way to go. We embrace it. We are ready to go. But it is important to consider several factors.

First of all, as Decker pointed out, we do not need legislation for the telephone companies to get into video and cable now. The courts have spoken in this area, and we are hopeful that you will simply affirm those decisions.

Second, there is a myth here at work. And that is that the size of the local telephone industry is such that cable companies need something of a head start to get into this; that we nave sort of mom and pop entrants here, ready to come do battle with the so-called 800-pound gorillas. But I do not think that is really the case.

Let me just quote very briefly from a Cox Cable annual report, in which Jim Robbins, the CEO of the company, says:

The telephone industry is a $100 billion industry and cable is a $20 billion industry. For us to get into their business—for cable to get into telephone—we need only spend X in capital investments. For them to get into our business, they need to spend at least 2, 3, maybe 4 times X. For that 2 to 4 times X, they get to chase a $20 billion pie. For our single X—meaning the cable companies—we get to chase a $100 billion pie. That paradigm drives my entire thinking. Can we run circles around these guys? Yes.

So much for the idea that cable needs a head start.

From Time Warner's annual report: Time Warner Cable posted record earnings of $1.035 billion in 1993, up from $977 million in 1992, due primarily to internal growth in subscribers and so on.

So, so much for the idea that we have a weak, vulnerable, new entrant. Cable is especially able to compete in this market.

The third myth here is that cable price regulation is strangling the industry. We do not oppose this committee, this Congress removing cable rate regulation here. But it is important to realize that there are clear signs that cable, especially the large cable operators, have had plenty of funds to invest, they are not small, they are not cash-strapped.

Myth No. 4 about this debate is that the price regulation for the cable industry is the same or even more stringent than that for the telephone companies. The fact of the matter is that telephone companies come under significantly more rate regulation, through various rate-of-return rules, that are not shared by either the cable industry or any other competitive entrants here.

Again, we do not oppose the lifting of rate regulation on cable, if that is what you decide to do. But do not think for a moment that this somehow levels the playing field among these various competitors here.

I think it would be helpful to point out exactly what kind of regulatory burdens exists now for telephone companies as they seek to compete for all kinds of services as compared to those for all the new entrants that you will make successful in your efforts to open up the local telephone market in this legislation.

I have a poster here. The information is included in the testimony. I will not go through it, but it notes approximately 20 major regulatory provisions—you can call them burdens, whatever—major regulatory provisions, burdens, restrictions, reporting requirements, and so on, that fall to the local telephone companies. These are essentially to larger and mid-size phone companies that do not fall on any potential competitor or existing competitor, whether it be cable, whether it be a competitive access provider, like Teleport, or whomever. These are rules that apply to telephone companies and not to their competitors.

Let me just give you an illustration here. This is a manual required by the FCC for telephone cost separation. It deals with only one regulation—only one regulation. There are 20 up here. So you could take this and multiple it times 20. None of our competitors—cable, CAP's, anyone—has to deal with anything like that. So that is an important point as you go through the process of considering a so-called regulatory level playing field.

Could we look at the second poster there?

We appreciate the work you have done to relieve some of the regulatory burdens. We have included some of those in our draft testimony. But you have done a number of things. You have eliminated the requirement of 214 for video after 1 year, and done several other things dealing with cable buyout prohibitions and so on.

But it is important to note that the committee draft that was released last month still imposes perhaps 10 or so new regulatory burdens on telephone companies that do not apply to competitors. And so these are just illustrations to point out the kind of continuing regulatory disparity facing the telephone companies alongside of all the new entrants.

Now, there are any number of good reasons to open up the local telephone market to competition. And we know that you are going to deal with these in a fair way and a thoughtful way. But the main thing to consider is, do not assume that by simply allowing these companies to get into each other's marketplaces that the job is done.

There are enormous regulatory problems facing our industry, the telephone industry—some facing Decker's industry, but the vast majority of them facing the local telephone industry—in being able to compete with cable for either cable services or to compete to keep telephone customers. It is a central issue. We appreciate the opportunity to be here, because this issue goes far deeper than just whether or not the cable operators will have their rates deregulated.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Neel follows:]

TESTIMONY OF ROY NEEL

President & CEO
United States Telephone Association

Before the Senate Committee on Commerce, Science and Transportation

March 21, 1995

Thank you, Mr. Chairman. My name is Roy Neel. I am President and CEO of the United States Telephone Association (USTA). USTA has approximately 1,100 member local telephone companies including the RBOCs, GTE, and Sprint, each of which has millions of customers, as well as over a thousand mid-sized and smaller telephone companies, many of which serve a few hundred customers.

One of the reasons that the Committee will be able to move to mark up a bill quickly is that, frankly, we have all heard much of this testimony before. So, rather than repeating myself, I have decided instead go to through the existing record and provide the Committee with a list of the top seven myths about current law and the reality of competition.

MYTH NUMBER ONE: LEGISLATION IS NEEDED TO ALLOW TELCOS TO COMPETE IN THE CABLE BUSINESS.

The fact is that the Courts - seven of them, in fact - have already determined that the 1984 cross-ownership ban is unconstitutional. The widest ranging of these cases is the class-action suit USTA and the RTC won in January. The ruling in this case enjoined the FCC from enforcing the ban on telephone companies competing in the cable business.

Prior to this string of court cases the telcos have been prevented from entering the cable business since 1970, when the first FCC rules on this subject went into effect. That's a quarter of a century for the cable industry to get on its feet. It is now time for the race between these competitors to begin.

MYTH NUMBER 2: THE AGGREGATE SIZE OF THE LOCAL EXCHANGE INDUSTRY DEMANDS THAT CABLE SHOULD BE GIVEN A REGULATORY HEAD START.

As a matter of fact, the cable industry itself has been telling the financial markets that because they have a broadband network, compared to the traditional telephone copper wires, the telcos will have to invest three and four times as much money to get into the cable business as they will have to invest to get into our business. In addition, since the local telephone market is more lucrative than the cable market, the cable industry has still another competitive advantage over the telcos.

Perhaps the best analysis of this argument about the relative size of our respective industries can be found in 1994 Annual Report of Cox Cable Enterprises:

> "The telephone industry is a $100 billion dollar industry and cable is a $20 billion industry. For us (cable) to get into the telephone business we need to spend X in

> capital investment. For them to get into the cable business they need to spend 2, 3 or maybe 4 times X. For that 2 to 4 times X they get to chase a $20 billion pie. For our single X we chase a $100 billion pie. That paradigm drives my entire thinking. Can we run circles around those guys? Yes!"

I submit to the Committee that the cable industry's own analysis suggests that if anyone should get a regulatory head start, it should be the telephone industry.

MYTH NUMBER 3: CABLE PRICE REGULATION IS STRANGLING THE INDUSTRY AND PREVENTING IT FROM INVESTING.

Time Warner's 1994 Annual Report documents that last year its cable business had record earnings before interest, taxes and depreciation of $1.035 billion -- up from $977 million in 1992.

Cox Cable's Annual Report boasts that last year it amassed record revenues of nearly $3 billion.

The big winner in last week's PCS auction was Wireless Co. LP, a consortium of Cox Cable, TCI cable, Comcast Cable and Sprint, which bid more than $2 billion and won 29 licenses.

Let me be clear about this. I am delighted that one of my member companies was able to do so well in the PCS auctions, and I think that this sort of cooperation between our industries is pro-growth. But, these facts suggest that the cable rate regulation regime has not strapped the industry to the point that it needs to be given regulatory advantages over the telephone industry.

MYTH NUMBER FOUR: PRICE REGULATION FOR THE CABLE INDUSTRY IS THE SAME OR MOPE STRINGENT THAN THAT OF THE TELCOS

First, USTA does not oppose the Pressler draft language granting price deregulation to the cable industry. We have never been supportive of the sort of market test that exists in the 1992 Cable Act which would eliminate cable price regulation only after a percentage of the market has been captured. However, we insist that the same standard be applied to the telephone industry that is being applied to the cable industry.

Since we are removing the barriers to entering each other's markets, competition - not regulation - should be the governing principle.

Second, if cable price regulation is considered excessive, then telco price regulation is far more onerous. Indeed, the telephone companies would welcome being regulated under the sort of price regulation scheme from which the cable industry is lobbying to get released.

The Price Cap plan the FCC has approved for the cable industry has no productivity factor and no limits on earnings. Under this plan cable prices are permitted to rise with inflation, and cable operators who are able to be more efficient, introduce a new service, or increase demand can keep all of the resulting profits. Indeed, it is the growth in these areas that explains the record cable company earnings we have already documented.

The Price Cap plan for telcos, on the other hand, requires that telcos make productivity improvements of 3.3% each year. The plan also contains earnings limits, similar to rate-of-return regulation, which further dampens our incentives.

The majority committee draft does take a progressive step in granting telcos price regulation for competitive services. However, under the majority committee draft universal service (a category that will presumably grow) will remain under rate-of-return regulation. Our cable competitors under this draft would have no price regulation at all.

As these two industries merge, their pricing regulation should also. Prices for basic, or universal non-competitive services should be regulated under a pure price cap plan such as the current cable model. Competitive services offered by either a cable or telephone company should be governed by the market.

Of course, there are some smaller telephone companies who, due to the markets they serve, are best left to traditional rate-of-return regulation. These small and mid-sized companies should have the option to maintain that more stringent regulation.

MYTH NUMBER FIVE: PASSAGE OF THE PENDING LEGISLATION WILL ALLOW FOR THE CABLE AND TELEPHONE INDUSTRIES TO COMPETE ON EQUAL REGULATORY FOOTING.

The assumption of some is that the draft legislation will allow telcos and cable companies to compete on even footing. This is a myth. Telephone companies will still be subject to massive regulation that would not apply to their cable competitors. We have prepared a chart for the Committee's consideration that details some of the regulatory requirements that telcos will be left with if the draft bill were enacted.

The first chart specifies the regulations currently in place for telcos and which will remain in place after the bill is enacted, but which will not apply to any new entrants, including cable companies. The second chart details the new burdens that telcos will have to endure under the draft which will also not be applied to our cable competitors.

Again, let me be clear about this. The majority draft does make some impressive strides toward deregulation. For example, there will be enhanced price regulation for telcos, but not nearly as streamlined as that currently existing for cable. 214 requirements for programming are eliminated after one year. And there is a biannual regulatory review and the possibility of forbearance.

But when the smoke clears, the fact is that telcos will be asked to compete under far heavier regulation than our cable and other competitors.

The charts detail the massive interconnection rules, equal access, unbundling, pricing restrictions, tariff requirements, cost allocations, annual audits, 214 applications, and in the case of the RBOCs, there would also be separate subsidiaries. All of these costly regulatory burdens would be non-existent for cable companies providing telephone services, giving the cable companies a massive competitive advantage.

Even if language is adopted granting some of our small and mid-sized companies waivers from the interconnection and unbundling rules, they will still be regulated far more heavily than their cable competition. This is true even if the cable competitor is the more dominant provider in the area.

Take for example one of our mid-sized companies, ALLTEL and Cincinnati Bell. In Ohio, these companies are preparing to compete against a Time Warner cable system which passes four times as many homes as ALLTEL does. Yet, it will be subject to far less regulation than the far smaller and less dominant local telephone company even if ALLTEL or Cincinnati Bell is granted a waiver from the interconnection rules in the bill.

Our proposed solution is not to regulate the cable companies as heavily as the bill will regulate the telcos. Although if we are forced to open our network to cable companies we think their network should be equally open to us. But the more appropriate solution would be deregulatory parity.

The premise of telecommunications reform is that competition, not government, should regulate the telecommunications market. Consequently, if members of this Committee support a level playing field, we strongly believe you should do more to deregulate local telephone companies in this legislative effort.

MYTH NUMBER SIX: FEDERAL LEGISLATION IS NEEDED TO ALLOW THE CABLE INDUSTRY TO COMPETE AGAINST THE LOCAL EXCHANGE INDUSTRY.

In his testimony before this Committee last May, Decker Anstrom included a NARUC study of competitive barriers in the states. That study documents that 28 of the 50 states already permit full or partial competition in the local exchange.

The question is why would some states choose to open up only part of the market to competition. The reason is that most of the local telephone business is not profitable. A wide range of studies have documented that residential telephone service is massively subsidized.

In general, residential rates cover only half the cost of providing basic telephone service in urban areas, and residential rates are subsidized far more heavily in rural areas. That means every one of us in this room are receiving hundreds of dollars of telephone subsidies each year.

Obviously you can't have a market that is simultaneously free and subsidized. And competing against subsidized residential service is a sure loser, so no one wants to compete in this area under current conditions.

However, the non-residential market is being widely opened to competition because that's where the money is, and that's where the cable industry is competing. Teleport, one of the most prominent competitive access providers, is a wholly owned entity of several cable companies including TCI, Time Warner, Cox, Continental and Comcast.

Further evidence of the growing competition in the local exchange, although not from cable, can be found in MCI's annual report which states: "By year end MCI metro will have fiber optic networks operational in 20 major cities. These cities represent 40% of the business access market."

MYTH NUMBER SEVEN: CABLE IS SEVERELY HANDICAPPED IN ITS ATTEMPTS TO PROVIDE UNIVERSAL SERVICE.

Universal service issues are intimately tied to pricing both for cable and telephone. That is because the intent of the legislative effort is to establish competition in both the cable and telephone industries, and pricing is an essential element of both.

USTA believes that in many markets there can be competition for traditional residential, or universal, service. And the cable industry, along with the electric utilities, satellite, and mobile providers, are likely competitors.

Indeed, the cable industry's own testimony before this Committee last year stated that "cable can reach 95% of American homes and, over the next five years their capacity will double. As such cable is in a position to become a facilities-based competitor to local telephone."

USTA believes that any facilities-based carrier should be able to be designated by the state commissions as the one area carrier of last resort for an existing LEC service area and hence be the entity that is eligible for universal service subsidy.

If rates are permitted to approximate costs - that is, if we can create a true market for residential service - then there can be competition that is not for subsidies, but for customers. The majority committee draft bill makes some progressive movement in the direction of more properly balanced rates. And I think that on this point - the removal of implicit subsidies from universal service - we should be able to reach agreement.

CONCLUSION

In summary:

1. Local telephone companies do not need legislation to enter the cable business.

2. USTA does not oppose the majority committee draft's move to curtail price regulation and the market tests mandated by the 1992 Cable Act. However onerous the price regulation method currently applied to cable is, it is far less burdensome than the price regulation system applied to telephone companies. This is because the cable price regulation system lacks productivity offsets and earnings limits.

3. The bill as currently drafted will create a largely inequitable playing field for telcos and cable. In some cases the large and more dominant cable conglomerates will have regulatory advantages over far smaller telcos. Prices must not only be deregulated, but there must be broad deregulatory parity for competition to flourish.

4. Cable interests, as well as others, can and already are, aggressively competing in the profitable business markets in most states. Cable industry annual reports document that it is financially able to compete and indeed is already in an advantageous position for the coming competition.

5. Telco prices, including those for universal service, must be adjusted as implicit subsidies are eliminated. This will permit true facilities-based competition on price and service in the residential telephone market.

Regulation of Local Exchange Carriers Compared to New Entrant Providing Comparable Services Under Communications Act

A. LEC* Regulatory Requirements	New Entrant Regulatory Requirements
Reports	
Quarterly reports detailing revenues, expenses, plant in service, depreciation and investment errors - report must be allocated in a regulated/non-regulated basis.	No comparable requirement
Reports on inside wiring service.	No comparable requirement
Annual reports on revenues, investments and expenses broken down by Part 32 accounts.	No comparable requirement
214 Approvals	
FCC must approve extension of lines	No comparable requirement
FCC must approve construction of new line.	No comparable requirement
Tariffs	
Must file copies of contacts with other carriers with the FCC within 30 days of execution.	No comparable requirement
New tariff offering or changes with existing tariff offering must be supported by explanation and data.	Tariffs filing relaxed — 14 days notice before going into effect
Cost Allocation	
Costs must be allocated between regulated and non-regulated activities and LECs must use attributable cost methodology.	No comparable requirement
LEC must file a cost allocation manual with the FCC.	No comparable requirement
Cost allocation manuals must be updated quarterly.	No comparable requirement
Cost allocation manual must be annually audited by an independent auditor that provides a positive opinion on the data contained therein.	No comparable requirement
Interstate Access	
LEC must provide expanded interstate access collocation.	No comparable requirement

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Jurisdictional Apportionment	
LEC subject to additional Jurisdictional Apportionment procedures.	No comparable requirement
Accounting	
LEC subject to a Uniform System of Accounts requiring more extensive accounting requirements.	Limited accounting requirements
B. LEC Requirements Under Pressler Discussion Draft (Proposed Additions to Current Law)	**New Entrant Regulatory Requirements**
Good faith negotiations for binding interconnection agreement.	No comparable requirement
Provide non-discriminatory access to network functions on an unbundled basis.	No comparable requirement
Non-discrimination on an unbundled basis to telecommunications facilities and information.	No comparable requirement
Interconnection at any technically feasible point.	No comparable requirement
Access to poles, ducts and conduits.	No comparable requirement
Number portability.	No comparable requirement
Services and functions unbundled for resale.	No comparable requirement
Collocation.	No comparable requirement

* LECs classified as Dominant, Tier I or Class A

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The CHAIRMAN. Next, we will hear from Richard Cutler, president of Satellite Cable Services, speaking for the Small Cable Business Association. We welcome you here.

STATEMENT OF RICHARD H. CUTLER, PRESIDENT, SATELLITE CABLE SERVICES, INC., SPEAKING FOR THE SMALL CABLE BUSINESS ASSOCIATION

Mr. CUTLER. Good morning, Chairman Pressler and members of the commerce committee. I appreciate the opportunity to visit with you about the new telco regulations, the new telecommunication legislation, and how it affects small cable companies, particularly ones like myself, which serve small towns and rural areas.

We began constructing cable in small towns in eastern South Dakota in 1980, and we now serve 57 communities, with 10,000 subscribers. Our largest system has 829 subscribers.

Our smallest system has 30 subscribers. In fact, of our 57 headends, 26 serve communities with less than 100 subscribers.

So I think you can see that we have built these cable systems relying on a de-regulatory environment, with no use of any universal funds or any government grants or loans.

I am also a member of the Small Cable Business Association, which was organized in May 1993, as a direct result of the 1992 Act and the FCC rules and regulations interpreting that Act. The SCBA now consists of 300 small cable operators, and those operators serve approximately 1.8 million subscribers.

The Cable Act of 1992 and the subsequent FCC rulings have a devastating effect on many small operators. We mistakenly believed that because we were providing good service at reasonable rates, the bill would not apply to us. Now, let us just go back a little bit in history.

The 1984 Cable Act deregulated cable and made it possible for people like myself, together with our bankers and some of our investors, to build cable TV in these small communities. In fact, Chairman Pressler continued to ask me why we cannot build a system in Humboldt, South Dakota. And Humboldt, South Dakota, was eventually built during this era of deregulation.

And, by the way, the company that built that is Douglas Communications, a member of our group, that is now having some financial trouble.

So, through this process, the bankers were willing to support us because they knew that as we provided these enhanced services in these small communities and brought on additional programming, we would be able to get rates to support this debt and the capital investment.

Well, in 1990, we started hearing about re-regulation of rates in cable. And all of a sudden the bankers got nervous. And you know when the bankers get nervous what happens—there is no money. And so, all of a sudden, building in these rural areas came to a halt, and expanding our systems and providing additional service became extremely difficult.

Then, of course, was the 1992 Cable Act. And when we read the Act, our first reaction was that many of our problems in the small industries were going to be solved, because it specifically spoke about taking care of the interests of small cable operators; it spoke about providing price parity in programming. And so we were feeling fairly good.

But then came the regulations. And the regulations were a monster. The first regulation provided, for example, that we were going to pay 38 cents per subscriber for this regulation. The only thing is, they said that they will assume that each headend has a minimum of 1,000 subscribers. That meant, for a town of 30 subscribers, I was going to pay the FCC a rate of over $12 per subscriber for regulation.

Now, they hired over 200 lawyers and economists, and they just forgot about any cable systems below 1,000 subscribers, like we did not exist. But, as many of you know, we are the ones that brought cable and brought this additional programming to these small towns of rural America.

Of our 350 members of the SCBA, we estimate approximately one-half of them are currently in trouble with their lenders. And in fact, we have a list of various members in 12 States, many of them in some of your States, that are now in some process of the foreclosure proceeding.

So it has become a very urgent matter for the small cable operators to be deregulated from this very onerous burden.

The FCC, through the SCBA, we continue to put in lots of pleadings. There was even a lawsuit brought. Some of you signed a letter—16 Senators, including the chairman—signed a letter through the small business committee to the SBA, asking them to intervene with the FCC, to make a different determination as to who were small cable operators.

All of your efforts have fallen on deaf ears at the FCC for some reason.

Sixty-five members of the Rural Caucus in the House petitioned the FCC to reconsider the issues involving small cable companies. They got kind of an arrogant letter back from the FCC saying we have considered them, and all of their needs are being met.

Well, I can assure you, as a small cable operator trying to comply with all of the paper processes, to file in all of the FCC proceedings—in fact, the SCBA did try to file in many of these proceedings. And by the end of the year, we were $100,000 in the hole for paying lawyers to file in these various proceedings.

In fact, when we had our annual meeting in February, the FCC came out with a new ruling to give some rate relief for small cable operators. And it sounded very good at the first blink. It said that we could get an inflationary adjustment of 5.2 percent. And then it went on to say that if you negotiated with your community, you could make an arrangement to provide additional service and get additional rates. And it all sounded very good. But then there was a caveat at the end.

It said that in order to do this, the community had to be certified.

Now, the FCC knew that virtually none of the rural communities are certified. Two of my 57 communities have certified. And they do not want to be certified. They do not want to spend the money with the lawyers.

One of my communities, the entire city budget is $65,000. How are they going to spend the money to have an FCC lawyer make the proper presentations and the proper filings in order to be certified and to get involved in this process? So, it just does not face reality. The people at the FCC do not seem to understand the unique issues of the small cable operators.

Now, there are a couple of items we would particularly implore you to exempt from rate regulation immediately upon the enactment of this legislation, the cable operators. And there are a couple of other sources that are pressure on rates that I think you could address.

First, we need fair pole attachment rates. The competitors are going to be the telephone companies and the utilities. And they control many of those power poles. And it is very important that the language of Section 204 be implemented so that there will be a fair determination on pole rates, so that everybody will be paying the same rates.

Also, it is very important that there be nondiscrimination in programming rates. Chairman Pressler and I have worked for the last 10 years to try to eliminate the pricing differentials between the large and small cable operators. And this has gone on and on.

In fact, in the 1992 Act, it was the intention of the legislature and Congress to eliminate that price disparity. But the FCC came and ruled that there was no intent on that part. And in the most recent filings, you will see that the rates on programming, for the same package, for a small cable operator versus a large cable operator, is 54 percent.

And so we cannot compete fairly if we are paying that kind of additional price for the programming. And now we have DBS and MMDS in our backyard. These providers are buying the programming at these lower rates, particularly the large DBS people. Hughes, with General Motors behind them, they are buying at the discount rates. They are selling into our backyard. They are buying the programming at these discounted rates.

So I hope that you will see the importance of that.

Now, all of us would probably like to say we would love to have a monopoly and maintain the monopoly, and we would like you to keep it in that form for us. But we recognize that is not reality. And so we do want to have competition, but we want it to be on a competitive, neutral basis with the rural phone companies.

If the rural phones companies are given an advantage over the rural cable companies, so that we cannot effectively get into the telephone business, we will not be able to compete. And also, it will be very important that we have the right for joint ventures, mergers and buyouts.

I thank you for your time, and I look forward to your questions.

[The prepared statement of Mr. Cutler follows:]

EXECUTIVE SUMMARY

Testimony Of Richard H. Cutler
President, Satellite Cable Services, Inc.
Speaking for The Small Cable Business Association (SCBA)
U.S. Senate Committee on Commerce, Science & Transportation
March 21, 1995

Mr Cutler began Satellite Cable Services, Inc in 1980 Today the company serves 10,000 customers in 57 systems in eastern South Dakota The largest system has 829 subscribers, and the smallest has 30 Twenty six of the systems have fewer than 100 subscribers

Satellite Cable Services built most of the systems, bringing cable to many of these communities for the first time All of these systems were financed using private money-- no universal service funds, government grants, or subsidized loans

Mr Cutler is a member of the Board of the Small Cable Business Association (SCBA) Organized in May of 1993, SCBA is an organization of 350 operators nationwide, mostly in small towns and rural areas SCBA members provide cable service to nearly 1 8 million customers The Association was formed when it became clear in the wake of the Cable Act of 1992 that no one was adequately advancing the real interests of small cable operators

The following issues are of primary importance to small operators in the proposed legislation

- ***Immediate exemption from rate regulation requirements of the Cable Act of 1992 and related FCC rules***

The FCC rules are lengthy, complicated, and in many instances, virtually incomprehensible to anyone other than a telecommunications lawyer The rules, regulations, notices, worksheets, forms, reconsiderations, and corrections of the rate regulation provisions alone seem to be approaching the size of the U S tax code There are more FCC lawyers, economists and others now regulating small cable operators than there are subscribers in ***many*** small systems!

The primary problem rate regulation causes small operators is that it is an open liability, and lenders and investors do not like uncertainty The door to reasonable financing opened for small operators and small systems with deregulation in 1984 That door slammed shut again in 1992

- *Non-discriminatory Program Rates for Small Operators*

Programming for cable TV is like the food in a restaurant, it's what we sell In early 1994, SCBA submitted information to the FCC in its rulemaking proceedings showing that a typical small system operator pays ***54% more per subscriber*** than the largest cable companies pay for identical programming At issue is the FCC's interpretation of Section 628 of the Cable Act to mean that "volume" is a legitimate basis for differentiated pricing between small operators and big ones

There is no documentation whatsoever placed before the FCC that it costs programmers any more to provide cable service to a small company than a big one, let alone 54%! We believe Section 628 should be amended to clarify that programming rates should be based on the cost of providing that service

- *Fair pole attachment rates*

This is one source of upward pressure on subscriber rates that easily can be alleviated by this bill The language in Section 204 prohibits the unfair practices of some utilities, and we strongly support the provisions of this section

- *Competitive Neutrality Between Telecommunications Providers in Rural Areas*

We applaud the Committee's commitment to competitive neutrality This legislation is about removing barriers and encouraging fair competition The law cannot be formulated so that the winner is anointed before the competition begins

Congress should not subsidize one entrant in the market while refusing the other Yet, rural telcos continue to lobby for special exemptions from or exceptions to opening markets, removing barriers, interconnection, access, and interoperability requirements Further, rural telcos continue to seek provisions that have the effect of denying small cable both entry into telephony and access to the Universal Service Fund

We trust you will be diligent about ensuring that *all* providers in the marketplace enjoy fair treatment in this landmark legislation

- *Provide reasonable opportunities for joint ventures, mergers and buyouts*

While competition is highly desirable, the reality is that most small towns, rural areas, and less viable communities may not enjoy the benefits of these new services any time soon unless potential providers are able to work together Implementation of these services will cost millions of dollars We believe that the wise course is to permit potential providers to work together

Moreover, since small cable operators have taken the risk and built these systems without government subsidies or REA loans, it seems over-regulatory to place arbitrary restrictions on who these cable operators can work with, partner with, or sell to

TESTIMONY OF RICHARD H. CUTLER
PRESIDENT, SATELLITE CABLE SERVICES, INC.
SPEAKING ON BEHALF OF THE SMALL CABLE BUSINESS ASSOCIATION
U.S. SENATE COMMITTEE ON COMMERCE, SCIENCE & TRANSPORTATION
March 21, 1995

Good morning Chairman Pressler and members of the Committee. I want to express to you my appreciation for being invited to discuss the proposed telecommunications legislation and how it would affect small cable TV operators like myself, who primarily serve small towns and rural areas.

I began the company in 1980, and we now provide cable service to a total of 10,000 subscribers in 57 communities in eastern South Dakota. Our largest system has 829 subscribers, and the smallest has 30. Twenty six of the systems have fewer than 100 subscribers. Our company built most of the systems, bringing cable TV to many small communities for the first time. We did it all with private money -- no universal service funds, government grants, or subsidized loans.

I am a member of the Board of the Small Cable Business Association (SCBA). The Association was organized in May, 1993, as a direct result of the Cable Act and the release of the first round of rules and regulations in April, 1993. SCBA now has 350 operator members, mostly in small towns and rural areas. The member companies serve 1.8 million customers nationwide.

The Cable Act of 1992, and the subsequent FCC rules, have had a devastating effect on many small operators. We mistakenly believed that because we were providing good service at reasonable rates, the bill would not apply to us. Instead, Mr. Chairman, there are more lawyers, economists, and others regulating my company than there are subscribers in most of my systems! And I bet not one of those regulators has ever provided any service to rural or small town America.

Top priority - immediate rate deregulation for small cable companies

It is interesting to note that rate deregulation in 1984 is what made small operators and small systems more attractive to banks and investors. For the first time, buying, building, upgrading, and operating small systems was appealing to lenders because rates could rise to reflect the capital investment.

However, by 1990, serious efforts were being made to re-regulate cable rates, and lenders started to get nervous about small cable loans. As we all know, a worried banker is a cautious banker. When the Cable Act of 1992 passed, followed by the release of the FCC's rate regulation rules in April, 1993, most small operators found that they no longer had access to any new sources of financing, and many of their current lenders were trying to get out of the loans.

Plus, the Commission put in place a rate freeze that was supposed to last three months, and ended up effectively lasting for 17 months. Because of the rate freeze, many small operators, particularly those who got into business in the mid to late 80's, began to default on their loans, with real or threatened foreclosure not far behind

There have been foreclosures in South Carolina, a bankruptcy in Kentucky, with many more small cable operators well along the road to losing their systems These are people who provide much desired services in small towns all over the United States They are jeopardized by alleged "experts" who are burying them in hundreds of pages of regulatory restrictions that the Commission itself cannot explain

How is a small cable operator with four employees supposed to deal with the same regulatory framework as the biggest cable conglomerate? How are we supposed to serve our customers and upgrade our networks when our resources must be directed at understanding and complying with regulatory requirements? We can't treat our customers badly We see them at church and the grocery store Our kids go to school together

This is a classic example of the disastrous effects of government regulation gone wild Since the passage of the Cable Act of 1992, the FCC has put out thousands of pages of rules, regulations, forms, worksheets, and on and on and on

We finally took the FCC to court to challenge the Commission's arbitrary definition of a "small company." To what end? The FCC's army of lawyers and seemingly limitless ability to spend the taxpayers money has the litigation tied up for the foreseeable future

We turned to Congress Sixteen members of the Senate Small Business Committee, including you, Mr Chairman, wrote to the Small Business Administration, instructing them to file an amicus brief in support of small cable taking the position that the FCC should adhere to the Small Business Act However, the FCC and SBA ignored your message and "negotiated" an agreement to speed up a cost study that is now long past due

A record 65 members of the House Rural Caucus wrote the FCC expressing their concern about the fate of small cable and its customers They got the classic Washington response detailing how regulators inside the beltway know better than elected Representatives what is best for their constituents

We believe that small cable was not the target of the 1992 deregulation provisions, but we and our subscribers are the victims While this is not a great environment for big cable, big cable is not suffering to the extent that SCBA members are Remember please, we have higher costs per subscriber than any others in the industry

This comes at a time when the Republican Party is calling itself the "Party of Main Street," and the Administration is announcing its commitment to regulatory reform Well, small cable businesses ***are*** on Main Street, and we ***certainly*** need regulatory reform

Being exempt from rate regulation will bring certainty to our financial situation, and that makes bankers happy It is our hope that there will be lenders and investors who are once again enthusiastic about small companies which operate small systems

Fair Pole Attachment Rates

As telephone and electric companies move into video and other competitive services, it is important that they not be permitted to be the bottleneck to competition. The Republican draft's pole attachment provisions in Section 204 eliminates a long standing special deal allowing certain utilities to hold up, hold hostage or price gouge small operators.

Whatever form the final bill takes, Congress should not on the one hand allow telco's and other government subsidized utilities into the cable television business while allowing those same new competitors to be a bottleneck by dictating terms and conditions for small cable operators to attach to their poles.

A major source of upward pressure on rates can be alleviated by this bill is by ensuring fair and non-discriminatory pole attachment rates. The language in Section 204 prohibits the unfair practices of some utilities, and we strongly support the provisions of this section.

Non-Discriminatory Program Rates

Another major issue for us is fair and non-discriminatory rates for programming. As you know, Mr. Chairman, this remains a volatile issue in South Dakota and other rural states. It still has not been resolved for small cable companies, in spite of Senator Pressler's best efforts. I am told that other members of the Committee are also concerned about this problem.

Programming for cable TV is like the food in a restaurant, it is what we sell. That should help the Committee understand why this issue is so important to us.

At issue is whether "volume" is a legitimate basis for pricing differences between small operators and big ones. The word "volume" is never mentioned in the '92 Act. In Section 628, programmers are permitted to establish "different prices, terms, and conditions to take into account actual differences, or other direct and legitimate economic benefits reasonably attributable to the number of subscribers served by the distributor."

Apparently, the FCC could think of no "direct and legitimate economic benefits" that were not volume related. Therefore, in its First Report & Order, adopted April 1, 1993, the FCC stated it would "permit vendors to establish pricing schedules based on volume-related factors." This has resulted in gross disparities charged on a per subscriber basis.

In early 1994, SCBA submitted information to the FCC in its rulemaking proceedings showing that a typical small system operator pays ***54% more per subscriber*** than the largest cable companies pay for identical programming. However, there was no documentation whatsoever placed before the FCC that it costs programmers ***any*** more to deliver this programming to a small system operator than to a very large one, let alone 54% more!

Even worse, the small operator's competitors now have access to programming at non-discriminatory prices by virtue of the other provisions of Section 628. The most expeditious way to correct this disparity is to delete from Section 628 the language relied on by the FCC which had no other purpose than to justify discriminatory pricing.

Parity between Small Cable Operators and Rural Telephone Companies

I want to touch briefly on what now is being called "competitive neutrality " It used to be called a level playing field, but the truth is out We now know that a level playing field means "What's mine is mine, and what's yours is negotiable "

Competitive neutrality is the foundation of this legislation which will serve as this country's telecommunications policy for many years to come Competitive neutrality, and the intellectual integrity of this legislation, are severely threatened by the attempts of small and rural telephone companies to receive special treatment in almost every competition oriented provision of this bill, be it removal of barriers to entry, access to universal service funds, build-out requirements, interoperability, interconnection, etc

Through absolute barriers to entry, disparate timetables, special exemptions from opening requirements, judgments left to state commissions, or unrealistic buildout requirements, rural telcos are advocating provisions which, when closely scrutinized, have the effect of allowing the telco to build a barrier around its service area precluding small cable entry at the very same time the telco is permitted into cable

These rural telcos have received decades of REA financing and Universal Service Fund subsidies They have guaranteed rates of return, and have established enormous reserves They have no need for -- and it is contrary to the principle of competitive neutrality to permit-- special provisions that give them, effectively, exclusive access to Universal Service Funds and create a barrier to small cable entry into telephony The net effect will be competition in big cities but no competitive choices for rural and small town America

Competitive neutrality will not exist unless true parity is achieved in each section of this legislation Once language has been made available, SCBA will be pleased to submit its analysis of where disparity has crept into the legislation and parity is lacking

Joint Ventures, Mergers and Buyouts of Small Companies

The Republican draft places no restrictions on joint ventures, mergers, and buyouts The Democratic draft placed size limitations on these activities Our position is that no restrictions are necessary and none are justified

Why? Because unlike government subsidized telcos, small cable companies have taken the risks necessary to build systems and serve customers All along the way, that meant making choices on financing, expansion, technological upgrades, etc

Congress may or may not succeed in getting the FCC to stop regulating my 30 subscriber system the same way it regulates huge cable conglomerates Congress may or may not eliminate the unfair and discriminatory pricing for programming or the special pole attachment exemption enjoyed by certain utilities Congress might mandate parity or it could enact special "disparity" favoring telco's

Whatever happens, Congress should not foreclose options for small operators who took a risk by telling us when, how and to whom we can sell our systems, merge, or do joint ventures. The correct policy is no restrictions, and there should not be an artificial ceiling placed in the way.

Some of my fellow small cable operators want to compete in new areas of telecommunications, and we know competitors will be in our business. But we also know that the wonderful new world of telecommunications will not come to most small towns and rural areas unless providers are permitted to work together.

These new services are not small ticket items. They will require multi-million dollar investments. Most small cable operators don't have that kind of money, and we suspect small telephone companies don't either. But, we can make exciting things happen if we can work together. I urge the Committee to carefully consider and support the benefits of cooperation between telecommunications providers.

That concludes my comments. Again, I very much appreciate the opportunity to be here today. I will be happy to answer any questions the Committee may have.

The CHAIRMAN. Thank you very much. We will be putting the full statements of everybody in the record.

We will next hear from the Consumer Federation of America, Mr. Bradley Stillman.

STATEMENT OF BRADLEY STILLMAN, TELECOMMUNICATIONS POLICY DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. STILLMAN. Thank you, Mr. Chairman. Good morning. Good morning, Senator Hollings, members of the committee.

It was just 5 years ago that this committee was the first in Congress to see that there was something seriously amiss in the cable industry. A bipartisan contingent of committee members recognized that the cable industry had abused its market power by blocking competition, discriminating against programmers, and raising rates to ridiculously high levels.

This committee recognized the irrefutable evidence that rates in those very few markets where there was head-to-head competition had cable prices nearly one-third lower than the rest of the country. And ultimately, it was this committee that said that $6 billion in overcharges to cable consumers was enough. And, through a bipartisan effort, the cable companies were finally reined in.

So the logical question to ask is, what has been the result?

First off, the FCC had a very difficult task. It was called upon to regulate a $20 billion industry. And this job was made even more difficult because there was essentially no publicly collected data about the industry between 1984 and 1992.

Still, the FCC was required to come up with a regulatory approach that would work for the entire country.

Now, looking at the industry numbers since regulation, programming rates have come down about $404 million. There has also been $827 million in reductions for equipment—such as convertor boxes and remote controls.

To get a full picture of this consumer savings we must remember that the cable industry had been raising rates at 3 times inflation. So without the rate freeze and the reductions, consumers would likely have seen increases totaling another $1.7 billion based on the historical trends.

This consumer savings is also reflected in the consumer price index. The CPI for cable is down 11 percent from the trend line during the period of deregulation. This represents a savings of at least $2.5 billion for consumers.

Even so, these reductions did not eliminate all of the inflated monopoly rates or return all excess revenues to consumers. The rules represent a good first step—a down payment of sorts—that leaves cable consumers better off than they otherwise would have been. The reductions, however, should be greater.

The cable industry continues to prosper—perhaps more than they should—because the FCC did not reduce rates enough.

According to Paul Kagen Associates, while under regulation, the cable industry has increased the number of homes passed, increased the number of subscribers, increased the revenues from the expanded basic tier, increased revenue from premium channels, mini-pay services, pay-per-view services, increased the revenue from digital audio services, and from other sources.

The plain facts indicate then that consumers are doing better, and the industry is doing just fine.

This committee had the foresight to build in an automatic sunset to rate regulation in the law—a point which is almost never mentioned by the industry. The problem for cable operators seems to be that the Act requires a competitor to actually be in the market before a company can be deregulated.

The question CFA has continually been asking itself is, what does the cable industry want to do to respond to a competitive threat that it cannot do under the Act?

Can they improve service?

Yes.

Can they reduce the price of their regulated tiers to respond to a competitor?

Yes. The benchmark is only a ceiling.

Can they increase prices when they add new programming to regulated tiers?

Yes. And they could do so at a premium above the benchmark rate.

If a competitor enters the market, for instance, with all a-la-carte services, can they respond and do the same?

Yes. And then those services are totally unregulated.

Can they create a tier of new programming in response to a competitor?

Yes. And this new tier is also unregulated.

And, finally, can they create a package of a-la-carte services together in response to a competitor, such as all sports programming, all public affairs and news programming?

The answer again is yes. And these services are unregulated.

Any of these actions can be taken by the cable operator without any prior approval or authority from regulators.

There seems to be only one thing that the cable operator cannot do, and that is raise its prices for regulated services above a reasonable level. Why would any company in its right mind, which fears losing customers to competition from DBS or from the phone companies or from anybody do such a thing?

The only answer I could come up with is that there is no meaningful competition to cable, and the facts support this conclusion.

Direct broadcast satellite service, which was cited by the previous panelists, has no more than 500,000 customers nationwide right now. That represents less than one-half of 1 percent of the cable industry's market penetration.

There is also a $700 up-front cost for the dish, as well as monthly programming fees. And it does not deliver local broadcast signals.

There is not a single commercial video dial tone service available in the entire country. So there is absolutely no actual competition from the telephone companies.

And when competition does arrive from the phone companies—and we think it may ultimately, but nobody knows exactly when—the rate regulations will sunset.

In conclusion, the cable industry promised to behave once before, and consumers got stung by huge rate increases and notoriously poor service. The committee got it right last time around. CFA believes the last thing Congress should do for the second time in a decade is deregulate the cable industry before competition actually arrives, and put consumers at unnecessary risk. Thank you, Mr. Chairman.

[The prepared statement of Mr. Stillman follows:]

Consumer Federation of America

STATEMENT OF

BRADLEY STILLMAN
TELECOMMUNICATIONS POLICY DIRECTOR
CONSUMER FEDERATION OF AMERICA

BEFORE THE

SENATE COMMERCE, SCIENCE AND TRANSPORTATION COMMITTEE

ON

THE CABLE TELEVISION INDUSTRY

MARCH 21, 1995

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

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SUMMARY

After the cable industry was deregulated in 1986, consumers were hit with the biggest rate increases in cable history. Rates skyrocketed at roughly three-times the rate of inflation. By 1992 when the industry was finally re-regulated, CFA found that cable rates were 28% above competitive market levels and cable consumer's were being overcharged $6 billion annually.

The monopoly cable industry is again asking Congress to deregulate rates before effective competition arrives. Such action will likely result in a return to the hyper-inflated rate increases and other monopoly abuses by the industry that were the norm prior to passage of the 1992 Act. Until actual competition arrives, consumers and potential competitors alike need regulation to protect them from abuse.

Despite industry claims, cable revenue numbers show impressive growth, even in the face of rate regulation. While the industry experienced declines in basic cable revenue and equipment revenue, increases in other areas went a long way toward making up that decline. So while consumers saved about $2.5 billion as compared to historical trends, after all of the revenue increases are added, cable industry revenues declined by only $538 million.

Since the Cable Act passed in October, 1992, the Kagen Index of cable stocks has increased by 47.8%. Over the same period, the S&P 500 increased only 11.2%. Debt financing by the cable industry has also climbed to $10.8 billion in 1994 from $6.9 billion in 1993. Even under regulation, it would appear that investors and lenders are comfortable with the overall health of the industry.

The most important policy question before Congress is, what would any reasonable business which was responding to competitive pressures seek to do that the cable industry can't do under the Act? The simple answer is nothing. The 1992 Cable Act and the Commission's regulations give a great deal of flexibility to the operators to respond to competition. An operator can do just about anything, except raise its prices in response to competition.

Despite cable industry claims that competition has arrived or that they are feeling competitive pressure, cable operators have not been able to demonstrate that a competitor or competitors are serving 15 percent of their market. Even DBS, perhaps the most real threat has accumulated less than one-half of one percent of the cable industry's market penetration.

The idea is simple: once competition arrives, rate regulation is no longer necessary. The cable industry wants to change or eliminate this test in an attempt to preserve its local monopoly or at least permit price gouging until there is actual competition. The cable industry de-regulation proposals should be rejected and the effective competition test preserved. CFA urges Congress to let the 1992 Cable Act continue to protect consumers from unreasonable rates until actual competition arrives. At that time, the rate regulation will automatically sunsets under the Act.

* * *

The Consumer Federation of America is a non-profit association of 240 pro-consumer groups, with a combined membership of 50 million, that was founded in 1968 to advance the consumer interest through advocacy and education.

I. Monopoly Abuses Led to Cable Re-regulation

In 1984, the cable industry came to Congress and asked to be deregulated. At the time, the industry claimed that serious competition was looming from satellite services and wireless microwave providers and others. Consumer advocates were concerned about the potential dangers of deregulation before competition actually develops. However, based in large part on the rosy scenarios provided by the industry, cable was de-regulated, effective 1986.

It quickly became apparent that consumers' worst fears were being realized. The monopoly cable industry took steps to stifle competition before it started. Service was terrible and in many places remains that way. Consumers were hit with the biggest rate increases in cable history. Rates skyrocketed at roughly three-times the rate of inflation.[1] By 1992 when the industry was finally re-regulated, CFA found that cable rates were 28% above competitive market levels and cable consumer's were being overcharged $6 billion annually.

The data submitted by the cable industry to the Federal Communications Commission ("Commission") indicated that rates in communities with two cable companies competing head-to-head had rates which were 28 percent lower than in the monopoly markets.[2] CFA and other

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[1] 1991 Survey of Cable Television Rates and Services; General Accounting Office, July, 1991. See also, Bureau of Labor Statistics-Consumer Price Index.

[2] MM Dkt. 92-266; First Report and Order and Further Notice of Proposed Rulemaking; Adopted April 1, 1993, Released May 3, 1993 at Appendix E page 12-13.

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public interest groups proposed rules which would have brought rates down to competitive market levels and saved consumers virtually all of the $6 billion in overcharges. The Commission went only part way. After the first full year of regulation, cable consumers saved approximately $2.5 billion in cable programming and equipment charges as compared to historical trends.[3] While CFA was happy to see some of the overcharges squeezed out of cable rates, we still maintain that the Commission should lower rates further to make them reasonable.

In 1995 it looks like *deja vu* all over again, as Yogi Berra said. The monopoly cable industry is again asking Congress to deregulate rates before effective competition arrives. Consumers want reasonable rates and protection from monopoly abuse by the cable industry, whether from competitive alternatives or through regulation. Deregulation of rates before actual competition arrives will likely result in a return to the hyper-inflated rate increases and other monopoly abuses by the industry that were the norm prior to passage of the 1992 Act.

II. The 1992 Cable Act is Pro-Consumer and Pro-Competitive

The most fundamental goals of the 1992 Cable Act are to bring the full benefit of competition to the cable market by eliminating discrimination in program distribution, and assure reasonable rates for cable service and equipment. As a general principle, CFA believes consumers are best served by competition. However, consumers want to receive the full benefits of competition even when market or other impediments slow its development. So until actual competition arrives a surrogate -- rate reductions to reasonable levels and access to programming for potential competitors -- is needed to protect consumers' interests.

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[3] Bureau of Labor Statistics, Consumer Price Index, Year End 1994.

The Cable Act is a model for legislation designed to protect consumers and potential competitors during the transition from monopoly to competition. The Act recognizes that regulation of rates is necessary only while a company retains its monopoly or has significant market power. The Act includes a built-in sunset, so rate regulation completely disappears once there is an alternative provider offering roughly equivalent service for consumers. There is no danger that rate regulation will prevent monopoly cable operators from competing fairly once competition actually arrives or that rules which are no longer useful or necessary will remain in effect.

CFA maintains that the only way to determine if a service is a true alternative -- a competitor -- to the incumbent cable monopoly, is whether consumers actually subscribe to the alternative. The Act does not require the incumbent cable monopoly to lose a specific percentage of market share before it can have it's rates deregulated. The alternative only needs to make its service available to half the households in a given market and have 15% of the households in the market as actual subscribers. This 15% can come from any households in the market, whether they currently subscribe to cable or not. The cable industry's penetration rate of roughly 60 percent means rate regulation could actually be eliminated if a portion of consumers in a community who do not subscribe to cable opt for the new alternative. CFA believes this is an extremely reasonable standard. Indeed, much of the economic literature defines a fully competitive market as one which contains five or six entities of roughly equal size offering equivalent services.

III. Cable Industry Attempts to Thwart the Act

It came as no surprise to anyone that re-regulating a $20 billion industry, especially one which was fighting at every step of the way, would be no easy task. Although it has been difficult, it has certainly been worthwhile for the American consumer and potential competitors who now have a realistic hope of getting a foothold in the business. Furthermore, many of the problems, delays and much of the excessive paperwork were generated by the cable industry itself and not the Act.

Although the 1992 Cable Act was passed by an overwhelming, bi-partisan super-majority, it seemed that many at the Commission never believed the bill would become law. The agency did not appear to take steps to prepare for implementation of the Act. As a result, some of the rate regulation proceedings got off to a rough start. Once a new chairman was confirmed and new staff reinvigorated the implementation process, efforts were made with some success to better reflect Congress' statutory mandate and improve the rate regulation outcome for consumers.

At the same time, however, the cable industry has attempted to overwhelm the Commission and thwart the purposes of the Act. For instance, many industry filings wasted the

Commission's time and tied it in knots by arguing against the plain language of the Act. The following are just a small sampling of the baseless arguments made by the industry:

- The Act explicitly states that the Commission must assure that rates for Cable Programming Services are "not unreasonable".[4] Several cable operators, including Time Warner, Comcast and TCI claimed that the Commission should establish a standard of regulation based on "egregiousness" instead.[5] The companies claimed that the Commission could only regulate the 2-5% of cable systems with the highest rates.

- The Cable Act requires that all equipment used by subscribers to receive the basic tier, including converter boxes and remote control units, must be regulated in a cost-based manner.[6] If a subscriber requests, this would include an addressable converter box or other equipment necessary to receive programming on other service tiers. Several industry commenters claimed that only equipment used by subscribers of the basic tier was subject to this provision. This narrow interpretation was explicitly rejected by the Conference Committee.[7]

- Some in the industry also tried to convince the Commission to ignore the actual cost language of the Act.[8] Instead the companies urged the Commission to set prices based on national average methodologies or load inappropriate costs into their proposals.[9]

- Several cable industry filings asked the Commission to define a multichannel video programming distributor as any entity (including a broadcaster) which

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[4] §623(c).

[5] See MM Dkt. 92-266, Comments of Time Warner at 38, 40; Comcast at 32-22; TCI at 27, January 27, 1993.

[6] §623(b)(3).

[7] See, H.R. Conf. Rep. No. 124, 102d Cong., 2d Sess. 1 (1992) at 64.

[8] §623(b)(3).

[9] Comments of Cablevision Industries at 38; Cox at 33; TCI at 38; Continental Cablevision at 36; Cablevision Systems at 13; NCTA at 52, January 27, 1993.

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> makes video programming available.[10] This ignored the statutory requirement that for purposes of the effective competition test, the alternative provider must offer comparable video programming. It also ignores the fact that Congress rejected earlier Commission rules which defined effective competition as 3 or 6 over-the-air broadcast channels.

Much has been said about the many pages of regulations and the number of proceedings which followed the Act. Most of those pages are not regulations at all. Rather, they contain history and descriptions of the comments filed by the parties. This predominantly includes responses to the high-powered cable lawyers' attempts to re-argue the Act and disregard it's plain language as described above.

With respect to the actual regulations themselves, much of the detail is largely designed to protect the cable industry, not consumers. For instance, there are hundreds of pages of detail which permits the industry to challenge the regulated "benchmark" rate as too low. There is no corresponding power for consumers to demonstrate that the "benchmark" rate is too high for their particular company.

The cable industry has also attempted to slow the regulatory process by bringing legal challenges to every portion of the Act and every regulation and ruling made by the Commission. Again, the fact that the regulations were completely in line with the plain language and intent of the Act was irrelevant to the industry and its lawyers.

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[10] Comments of Continental Cablevision at 6; TCI at 13; Cablevision Industries at 63; Time Warner at 11, January 27, 1993.

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IV. The Cable Industry is Thriving Under Regulation

When Congress was debating passage of the 1992 Cable Act, many in the industry claimed that operators would be forced into bankruptcy, the industry would be unable to increase program offerings, improve service or compete in the broader telecommunications market. The bankruptcy's never came, new programming is abundant, there is a new campaign to improve service and billions of dollars are being invested by the industry. It is time to cut through the cable industry rhetoric and look at what's really happening in the marketplace.

The industry has seen increases[11] in all of the following in the past year alone:

- number of homes passed (up 1 million)
- number of total new subscriptions (up 5.29 million)
- number of basic cable subscribers (up 1.4 million)
- number of expanded basic cable subscribers (up 1.08 million)
- number of pay cable subscribers (up 2.01 million)
- number of mini-pay subscribers (up 800,000)
- number of new programming channels

- enhanced basic revenues (up $229 million)
- cable television advertising revenues (both local, regional and network up $644

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[11] The Kagan Media Index, February 24, 1995.

million)

- digital audio revenue (up $25 million)
- home shopping revenue (mostly carried on and owned by cable, up $430 million)
- mini-pay and premium channel revenue (up $37 million and $293 million respectively)
- Pay-per-view revenue (up $112 million)

The actual industry revenue numbers show impressive growth, even in the face of rate regulation. Between 1993 and the end of 1994, the industry experienced declines in basic cable revenue of $404 million and equipment revenue of $827 million. During the same period, however, new revenues from pay services and advertising alone totalled $740 million. After all of the revenue increases are added, cable industry revenues declined by only $538 million. In light of the fact that reasonable rates would have resulted in a 28 percent rate decrease, the industry has done quite well.

Just looking at revenues doesn't tell the entire story. Stock values of the cable MSO's have risen dramatically as compared to the Standard and Poor's 500 ("S&P 500"). Since the Cable Act passed in October, 1992, the Kagen Index of cable stocks, the primary measuring tool for the industry, has increased by 47.8%. Over the same period, the S&P 500 increased only 11.2%. In fact, in every month since passage of the Cable Act, the Kagen Index has exceeded the pre-regulation trend line. CFA does not believe this is the mark of an industry hamstrung by regulation. On the contrary, investors seem bullish on the industry and prospects for cable's ability to take on the local telephone monopoly.

Another important measurement of investor confidence, debt financing by the cable industry, has climbed to $10.8 billion in 1994 from $6.9 billion in 1993. This growth has been steady since 1991 when there was a "credit crunch" in the banking industry.[12] Even while the Federal Reserve Board was raising interest rates to stave off inflation, banks continued to provide private debt to the cable industry. Even under regulation, it would appear that lenders are comfortable with the overall health of the industry.

In addition to all of these measurements which indicate a very healthy industry under rate regulation, one need only pick up a newspaper over the past few months to see that the industry players seem to have access to plenty of money to invest[13]:

February 1995, Time Warner offers $2.7 billion for Cablevision Industries systems

January 1995, Time Warner offers $2.244 billion for Houston Industries systems

January 1995, Intermedia Partners, TCI and others offer $2.3 billion for Viacom's systems.

November 1994, Continental Cablevision offers $1.4 billion for Providence Journal's systems.

September 1994, Time Warner offers $3.2 billion for Newhouse's systems.

September 1994, Time Warner offers $337 million for Summit's systems.

August 1994, TCI offers $1.56 billion for Tele-cable's systems.

June 1994, Cox Communications offers $2.3 billion for Times Mirror's systems.

June 1994, Comcast offers $1.27 billion for Rogers Communications' systems.

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[12] Paul Kagan Cable TV Finance, December 1994 newsletter.

[13] Wall Street Journal, February 8, 1995.

The industry has also been active at the state level, including Florida, Georgia, North Carolina, Ohio, Texas, Virginia, Missouri and Arizona, announcing its intention to get states to open up the local telephone market to competition. Many cable companies have committed to making the network investments necessary to offer telephone service as well as cable.

And most recently, a consortium made up of TCI, Cox, Comcast and Sprint just spent $2.1 billion dollars on 29 PCS licenses. Cox also will pay $250 million for a license in southern California. In fact, this consortium of cable companies spent more money than any other bidder in the entire auction.[14] One has to wonder, where's the substance behind the rhetoric of the cable industry? The evidence is clear, the cable industry has fared well under this pro-consumer, pro-competition regulation. Indeed, CFA maintains that in light of this and other evidence, the Commission should take action to reduce cable rates further.

V. The Cable Industry is Not Competitively Disadvantaged By The Act

The most important policy question before Congress is, what would any reasonable business which was responding to competitive pressures seek to do that the cable industry can't do under the Act? The simple answer is nothing. The 1992 Cable Act and the Commission's regulations give a great deal of flexibility to the operators to respond to competition. An operator can do just about anything except raise its prices in response to competition. It is difficult to believe a company that was truly interested in responding to competition would take such a step.

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[14] Multichannel News, March 20, 1995.

A competitor will most likely enter a market where it believes it can provide an equivalent or better service and charge a lower price than the incumbent. In most cases, the response of the incumbent would be to lower its prices and add new services to make it's service more distinctive or more competitive. Under the Commission's regulations, as new services are added to regulated tiers, the incumbent can raise the price it charges. There is nothing in the 1992 Cable Act or in the regulations established by the Commission which prevent a cable operator from responding fairly to competition.

The rate regulation benchmark operates as a cap on prices. If a competitor comes in to a market with a lower price, the incumbent is completely free to lower its price, without any sort of pre-approval or certification by the Commission or local authorities. What the incumbent cannot do is discriminate (i.e. engage in unfair competition through predatory pricing by lowering the price for some people and not for others in an effort to drive the new entrant out of the market).

In addition to being able to respond to competition based on rates, the industry has been granted a great deal of flexibility in the way it can market its services. Cable operators are permitted under the regulations to add new programming to regulated tiers at a premium price to consumers above and beyond what they would normally be permitted to charge under the "benchmark", again without any pre-approval or certification. They can add these programs and raise prices whether consumers want the new programming services or not.

Operators are free to offer any programming service either on an a-la-carte or stand alone basis or in a package of other a-la-carte services at any time, without first obtaining permission from regulators. The prices for these services are totally unregulated. They can also create a new tier of services with new programming which will remain totally unregulated. If a competitor enters the market with an all sports tier, the cable operator can respond. If the competitor enters the market with a news and public affairs package, the cable operator can respond. Each and every one of these things, and more, can be done without the operator first obtaining authority from federal or local regulators.

There is also nothing which would prevent the incumbent cable operator from improving the quality of service. The industry has recently launched a program to improve its image in an effort to convince consumers that the cable industry will provide more reliable service in the future, including for local telephone service when cable enters that market. Again, the real question is what can't the monopoly cable industry do, other than raise rates, in response to competition. The answer: Virtually nothing.

One thing the industry cannot do, and CFA urges Congress and the Commission to prevent, is upgrade the cable network through excess profits. CFA believes Congress and the Commission have a fundamental obligation to prevent any industry from building the information infrastructure on the backs of captive customers. The cable industry believes this too, except only with respect to others.

CFA has been at the Commission and in the offices of this very committee, at times even with the NCTA, to make sure that local monopoly telephone companies are not permitted to overcharge local telephone ratepayers as a means of getting into the video business through video dialtone. Indeed, CFA and NCTA have gone so far as to file a joint petition and other documents with the Commission to establish clear rules to prevent this kind of monopoly abuse. In our petition, NCTA and CFA said:

> "The pending [video dialtone] applications demonstrate that the threat of cross-subsidy remains alive and well with respect to video dialtone offerings, notwithstanding earlier speculation that existing regulatory safeguards and purportedly eroding monopoly power of local exchange carriers had reduced that threat."[15](emphasis in original)
>
> "The consequences of inaction are clear. If an excessive share of jointly-used plant is assigned to telephone service, telephone rates will be greater than justified and the rates for video dialtone service will not reflect the full costs of providing that service."[16]
>
> "Emerging competition may actually increase the danger of cross-subsidies, as the local telephone company attempt to lower the prices of services potentially subject to competition by raising the prices of services not subject to competition (or by failing to reduce prices that should be reduced). Regulators must respond to the mixture of competitive and monopoly services with appropriate safeguards. Only when all telephone company prices are constrained by the presence of competitive alternatives will the need

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[15] National Cable Television Association and Consumer Federation of America Joint Petition for Rulemaking and Request for Establishment of a Joint Board; Federal Communications Commission; April 8, 1993 at 3. Citing New Jersey Cable Television Association Reply to Opposition to Petition to Deny, File No. W-P-C-6840 (Filed Feb. 12, 1993), App. A (Affidavit of Leland L. Johnson) at 2-3.

[16] id at 13.

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for regulation be reduced."(emphasis in original)[17]

We believe the same principles, designed to protect captive customers and prevent unfair competition, must apply to all sectors of the telecommunications market equally. The cable industry would apply these principles only to others and not itself.

The cable industry has argued eloquently that consumers should not be forced to pay for the network build-out for competitive ventures of the monopoly telephone company. CFA whole-heartedly agrees. We also believe that consumers should not be forced to pay for the build-out for competitive ventures of the monopoly cable company, whether it is entry into the telephone business or improvements to the cable network in response to a competitive threat. In either case, the monopoly company would have an unfair competitive advantage at the expense of captive customers. Indeed, if this type of anti-consumer, anti-competitive practice were permitted, the result would be both cable and telephone charges far higher than they should be, or would be in a competitive market.

Upgrades by monopoly companies should be done with shareholder money or with funds obtained from the capital markets, just like any competitive venture. If the money lenders on Wall Street are not willing to take the risk, and it cannot be done through re-investment of reasonable profits, then it probably should not be built because it will be uneconomic from the outset and will require excessive rates to support it. It certainly should not be built on the backs of cable monopoly ratepayers. In this case, regulation has not prevented Wall Street from supporting cable's build-outs and expansion into other markets.

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[17] Id. Cross-Subsidy Concerns Raised by Local Exchange Carrier Provision of Video Dialtone Services, Hatfield Associates, Inc., March 29, 1993 at 10.

VI. The Cable Industry is Trying to Gut the Act

Many in the cable industry have portrayed attempts to limit rate regulation to the basic service tier or to make changes to the "effective competition" standard as nothing more than fine tuning of the Cable Act. Nothing could be further from the truth. The industry proposed changes would either eliminate regulation of all popular cable programming or all rate regulation while their cable monopoly persists. The result for cable customers would almost certainly be significant rate increases.

In deference to the industry's First Amendment rights, the Act only requires that broadcast and public access channels be offered on a basic tier, although the operator has the flexibility to include anything else as well. If regulation were limited to basic cable, cable operators would have an overwhelming financial incentive to move all popular satellite-delivered cable channels to an unregulated, higher-priced tier. Currently, approximately 90% of cable consumers subscribe to a service which includes some satellite delivered programming such as CNN, ESPN, TNT, MTV, Discovery, Arts and Entertainment etc. Under the industry proposal then, consumers who wish to receive the programming they have today, will have to purchase an unregulated tier of service at a much higher price.

Cable programming services like those listed above are the ones which drive the purchase decision for most cable consumers. In other words, cable companies want the freedom to raise rates on the most popular cable programming because that is precisely where they can get away with it while the monopoly persists. CFA believes one of the cornerstones of the Cable Act was to regulate all tiers of service under the same formula to prevent "gaming" of the regulatory system and to discourage the operators from stripping popular programming out of the basic tier. This industry proposal virtually guarantees these abuses will occur and rates will go up.

VII. There is Little Competition to Cable

Despite cable industry claims that competition has arrived or that they are feeling competitive pressure from Direct Broadcast Satellite (DBS), microwave wireless cable and others is totally unsubstantiated. Other than those few companies that faced head-to-head competition before passage of the Act, cable operators have not demonstrated to the Commission that a competitor or competitors are serving 15 percent of their market.

The effective competition test is simple, straight forward, and easy for the Commission to administer. The cable operator and it's competitors are required to provide data on penetration levels and services areas. The "effective competition" test is simple and easily reviewable by the Commission. The DBS industry, which many believe is cable's most likely, near-term competitor, has developed a measurement of subscribers on a zip code basis. This will be made available to the Commission. It will not be difficult to determine when alternative providers of video services are available to 50% of the market and 15% of the consumers in the community actually subscribe to the alternative service.

The idea is simple: once competition arrives, rate regulation is no longer necessary. The cable industry wants to change or eliminate this test in an attempt to preserve its local monopoly or at least permit price gouging until there is actual competition. In essence, the industry is asking Congress to permit it to operate as a virtually deregulated monopoly for as long as it can. CFA believes the cable industry proposals would cost consumers billions of dollars in excess cable rates.

Although Congress took important steps designed to help spur competition to cable in the 1992 Act, a review of the market shows that competition is growing very slowly. Even the introduction of DBS, which the cable industry points to as the most serious competitor, has only attracted at best, 400,000 to 500,000 customers. This represents less than one-half of one percent of the cable industry's market penetration. In addition, DBS requires at least a $700 up-front investment in a satellite dish in addition to the monthly service fees, and it does not deliver local broadcast or public access, educational and governmental channels. Telephone company entry into the video business remains only a theoretical threat. There is not a single commercial video dialtone system operational today, so there is no actual competition from the local telephone companies.

While competition from a variety of sources may be on the horizon, it has not yet arrived. Competition cannot be wished to a market; that is what happened in 1984 and led to massive consumer and competitive abuses. Consumers need protection from the cable monopoly until real competition develops. Only actual competition or regulation will effectively constrain cable prices and keep them reasonable. Until effective competition develops, the Cable Act allows cable operators to respond as any reasonable business would to threats of competition.

VII. Conclusion

The cable industry de-regulation proposals should be rejected and the effective competition test preserved. CFA urges Congress to let the 1992 Cable Act continue to protect consumers from unreasonable rates until actual competition arrives. The Act has not prevented the cable industry from being a full participant in the information revolution, rather it is simply preventing them from competing unfairly and abusing consumers.

The CHAIRMAN. Thank you.

Mr. Gerald Hassell, senior executive vice president, the Bank of New York.

STATEMENT OF GERALD L. HASSELL, SENIOR EXECUTIVE VICE PRESIDENT, THE BANK OF NEW YORK

Mr. HASSELL. Good morning, Mr. Chairman and members of the committee.

The Bank of New York has had a long and substantial involvement in the broadcasting, cable television, and telecommunications industries. We have extended loans to some of the founding companies in these industries, dating back to the late 1940's in the case of broadcasting, and the early 1960's in the case of cable television.

During that time, the Bank has been a consistent, long-term-oriented supporter of the development of these businesses. Today we have over $6 billion in loan commitments to these industries, $2 billion to cable television alone.

I understand that this committee hopes to create a competitive market for telecommunications services. I concur with that objective.

But I am here today because I am concerned that two rounds of enormously complex cable television rate regulations enacted over the past 2 years may in fact, if left un-remedied, lead ultimately to less competition.

True competition in telecommunications will only develop if both cable television and the phone companies not only survive, but flourish. Specifically, I recommend that expanded basic programming and premium programming should no longer be subject to price regulation.

Regulation of basic programing and certain service activities could be retained. This would create the necessary financial incentives and rewards for future capital investment, while protecting the consumer regarding broadcast basic programming.

Many of us in the banking community believe that the cable companies are the most likely source of competition for the local phone companies. Cable is prepared to invest tens of billions of dollars to upgrade their national and local infrastructure with advanced technologies. These investments would allow cable to build systems that will offer enhanced and expanded product offerings, and which will compete directly with the local telephone companies.

However, I question the cable industry's resolve and ability to make these expenditures. Cable regulations currently provide little incentive for cable companies to rebuild or improve their systems. The FCC takes no account of the cost or vast public benefits of rebuilds and investments for cable.

FCC regulations restrict the ability of cable operators to respond to competitive pressures with enhancements and with alternative packaging of their services. In addition, these regulations can only be lifted after an operator loses 15 percent of its market share, which is an unacceptably high figure. And perhaps most troublesome is the continuing absence of certainty regarding cable's regulatory environment. The notion that cable's nonbasic business and new ventures will continue indefinitely to be micromanaged by the Federal regulators is most unsettling.

Cable companies face considerable disadvantage vis-a-vis the telcos. Cable bond ratings are consistently much lower. And cable's equity cost of capital is substantially higher.

At the same time, cable's financial performance has suffered greatly in the wake of rate regulations. Despite continued subscriber growth, cable industry revenues were flat last year, for the first time in history. Major cable companies experienced cash-flow reductions of 5 to 10 percent.

In just the past year, companies representing 17 percent of the Nation's cable subscribers have either merged out of or are in the final stages of exiting the industry.

In 1994, the amount of capital that the cable industry raised in the public debt market totaled only $1.5 billion, which is an 87 percent drop from 1993's level. The entire high yield debt market experienced only a 38 percent decline during that period. No major domestic cable company completed an initial public offering of equity during 1994.

Our bank has supported the cable industry's efforts to expand and grow for over 30 years, and we continue to believe that cable can be a successful long-term competitor. But today, in light of the cable industry's regulatory environment and the direct and future competition from the telcos, it is extremely difficult for us to be supportive of the industry's efforts to build am advanced infrastructure.

By the nature of our business, we are making decisions today that have 8, 9 and 10 year implications.

If Congress will enact some comprehensive measures to increase competition in telecommunications and at the same time provide appropriate regulatory relief for the cable industry, capital will continue to be available to the cable companies.

We understand and support the need for true competition in telecommunications, and we are anxious to see the delivery of the next generation of telecommunications services to business users and consumers. Thank you very much.

[The prepared statement of Mr. Hassell follows:]

Statement of Gerald L. Hassell
Senior Executive Vice President
The Bank of New York
to the Senate Commerce Committee
March 21, 1995

Executive Summary

Two rounds of enormously complex cable television rate regulation enacted over the past two years may in fact, if left unremedied, lead ultimately to less competition in telecommunications.

Cable regulations currently provide little incentive for cable companies to rebuild or improve their systems. The FCC takes no account of the costs or vast public benefits of rebuilds and investments for cable; and it has indicated that it has no plans to do so in the future. And perhaps most troublesome is the continuing absence of certainty regarding cable's regulatory environment. The notion that cable's non-basic business and new ventures will continue indefinitely to be micromanaged by Federal regulators is most unsettling.

Our Bank has supported the cable industry's efforts to expand and grow for over 30 years, and we continue to believe cable can be a successful long-term competitor. But today, in light of the cable industry's regulatory environment, and the direct and future competition from the telcos, it is extremely difficult for us to be supportive of the industry's efforts to build advanced infrastructures.

If Congress will enact comprehensive measures to increase competition in telecommunications and at the same time provide appropriate regulatory relief for cable companies, capital will continue to be available to the cable industry.

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Statement of Gerald L. Hassell
Senior Executive Vice President
The Bank of New York
to the Senate Commerce Committee
March 21, 1995

Good morning Mr. Chairman and members of the committee. My name is Gerald Hassell and I am a Senior Executive Vice President of The Bank of New York.

The Bank of New York has had a long and substantial involvement in the broadcasting, cable television and telecommunications industries. We extended loans to some of the founding companies in these industries dating back to the late 1940's, in the case of broadcasting, and the early 1960's, in the case of cable television. I, personally, started following these areas as a junior banking officer in 1975. During that time the Bank has been a consistent, long term oriented supporter of the development of these businesses. Today, we have over $6 billion in loan commitments to these industries -- $2 billion to cable television alone. Virtually all the major cable television and telecommunications companies are our customers.

I understand that this Committee hopes to create a competitive market for telecommunications services. I concur with that objective. But I am here today because I am concerned that two rounds of enormously complex cable television rate regulation enacted over the past two years may in fact, if left unremedied, lead ultimately to less competition. True competition in telecommunications will only develop if both cable television and the phone companies not only survive but flourish.

Specifically, I recommend that expanded basic programming and premium programming should no longer be subject to price regulation. Appropriate, non-punitive regulation of basic programming and certain service activities could be retained. This would create the necessary financial incentives and rewards for future capital investment while protecting the consumer from egregious pricing practices for broadcast basic programming.

Many of us in the banking community believe that cable companies are the most likely source of competition to the local telephone industry. Cable television executives tell me they are prepared to invest tens of billions of dollars to upgrade their national and local infrastructure with advanced technologies. These investments would allow cable to build systems that will offer enhanced and expanded product offerings and which will compete directly with the local telephone companies.

However, I question the cable industry's resolve and ability to make these expenditures. Cable regulations currently provide little incentive for cable companies to rebuild or improve their systems. The FCC takes no account of the costs or vast public benefits of rebuilds and investments for cable, and it has indicated that it has no plans to do so in the future.

FCC regulations restrict the ability of cable operators to respond to competitive pressures with enhancements and with alternative packaging of their services. In addition, these regulations can only be lifted after an operator loses 15 percent of its market share, which is an unacceptably high figure. And perhaps most troublesome is the continuing absence of certainty regarding cable's regulatory environment. The notion that cable's non-basic business and new ventures will continue indefinitely to be micromanaged by Federal regulators is most unsettling.

Cable companies face a considerable disadvantage vis-à-vis the telcos in their ability to finance upgrades and new systems. While telco revenues exceed $100 billion annually, the cable industry generates only about $25 billion each year. Cable bond ratings are consistently much lower than those of the telcos, and cable's equity cost of capital is substantially higher.

At the same time, cable's financial performance has suffered greatly in the wake of rate regulation. Despite continued subscriber growth, cable industry revenues were flat last year for the first time in history. Major cable companies experienced cash flow reductions of five to ten percent. The value of cable stocks dropped over by 6 percent from September, 1993 to date, while the S&P index rose by 6 percent. And most telling, in just the past year companies representing 17 percent of the nation's cable subscribers have either merged out of or are in the final stages of exiting the industry.

Cable's regulatory environment has had a significant impact on the industry's access to capital markets. In 1994, the amount of capital that the cable industry raised in the public debt markets totaled only $1.5 billion, which is an 87 percent drop from 1993's level. The entire "high yield" debt market experienced only a 38 percent decline. No major domestic cable company completed an initial public offering of equity during 1994, although several American cable companies operating in the United Kingdom, where cable regulation is much more supportive, did successfully undertake initial public offerings.

Our Bank has supported the cable industry's efforts to expand and grow for over 30 years, and we continue to believe cable can be a successful long-term competitor. But today, in light of the cable industry's regulatory environment, and the direct and future competition from the telcos, it is extremely difficult for us to be supportive of the industry's efforts to build advanced infrastructures. By the nature of our business we are making decisions today that have, eight, nine, ten year implications.

If Congress will enact comprehensive measures to increase competition in telecommunications and at the same time provide appropriate regulatory relief for cable companies, capital will continue to be available to the cable industry.

We understand and support the need for true competition in telecommunications, and we are anxious to see the delivery of a new generation of telecommunications services to business users and consumers. I hope this Congress will pass legislation that will allow all of this to occur.

Thank you.

The CHAIRMAN. Thank you.

We have 15 Senators here, so I am going to ask for 8-minute rounds of questions, and we will have second rounds.

Mr. Cutler, your testimony mentions an FCC cost study and the fact that small cable operators have higher costs per subscriber than large cable operators. Did the FCC take this into account in setting small cable's benchmark rates?

You also discuss a number of problems unique to small cable companies across the United States. I guess they would be in California and New York as well as every State. Will the deregulation effort solve this problem?

Mr. CUTLER. Well, you mention a number of things. The States that are involved with small cable operators that are in trouble are South Carolina, Kentucky, California, Indiana,

New Hampshire, Vermont, Maine, Mississippi, Washington State,

Oregon, Pennsylvania, and Nebraska. These are where there are currently preliminary foreclosure and foreclosure proceedings going forward against small cable operators.

You asked about whether deregulation would solve some of our problems. Certainly as our banker friend mentioned, certainty with bankers is very important. If the small cable operators are deregulated, we will be in a position to compete—particularly now—with DBS, which will mean that we need to broaden our offerings.

We cannot have systems in these small towns with 12 channels of cable. We need to have 20 channels and 30 channels of cable. This will require rebuilding the cable systems. It will require increasing our offerings.

And so we need to have that opportunity so that we can compete with the MMDS and the DBS providers.

The CHAIRMAN. Mr. Stillman, what would your response be to small cable's arguments? And also, last Friday, a Federal judge ruled that the regional Bells can begin providing video dial on a larger basis—or at least one of them can. It will probably be extended to all of them.

Is there not now enough competition from DBS and the Bells, so that there is competition in the cable area?

So I guess my question is a two-part one, dealing with the small cable company issue—how would you deal with that or respond to that? Because some of these small towns probably would not be wired if it were not for small cable companies and probably will not be in the future.

Mr. STILLMAN. Well, Mr. Chairman, with respect to the issue of small systems, we understand that the situation is significantly different for the truly small, independent companies, who do not benefit from the economies of scale and scope of the larger companies in this industry. And we have never objected to any attempts at the FCC to provide relief for these small, independent operators. And that would continue to be our position.

In addition, we negotiated with some of the small companies back in 1992, to try and see if we could come up with some reasonable relief for those companies who were going to be burdened, perhaps unfairly, in a small number of cases by the 1992 Cable Act. But the industry itself and those companies that we were negotiating with had decided at the time that they were going to cast their lot with their bigger brothers in the cable industry and try and fight for no regulation for anybody in the industry, instead of trying to come up with a fix for the small, rural operators.

The CHAIRMAN. Now, this is addressed to anybody on the panel. Price controls have preceded a marked drop in cable companies' revenues and overall value. How then have price controls impacted access to the capital needed for future investment and risk taking?

I guess maybe that would fall in Mr. Hassell's area mostly.

Mr. HASSELL. Cash flows declined last year, as I said, between 5 and 10 percent for most cable companies. The basis by which we lend to these companies is based on cash-flow, not on revenues.

To the extent that they do not generate cash-flow, they do not have ability to borrow.

The CHAIRMAN. But is that due to price regulation, or is it due to DBS and other competition?

Mr. HASSELL. Both. [A brief interruption.]

The CHAIRMAN. Staff tells me that is interference with the police channel.

Senator ROCKEFELLER. Mr. Chairman, I do not know where that is coming from, but I certainly think it is appropriate that it either be turned off or the person who has it leaves the room.

The CHAIRMAN. Mr. Cutler, you talked about the competition or the relationship between the small cable companies and the rural telcos and so forth. Would you expand on that a little bit?

Mr. CUTLER. Well, at this point, we both are very defined in our business. But I think we are going to see, through the legislation and so on, that there will be the opportunity for competition. But I think in the rural areas what we are going to see are joint ventures, various kinds of arrangements, so that these new technologies can be provided in these communities. But they are very expensive. And to duplicate those in the towns the size that we are serving is just not realistic.

So that is why the joint ventures and merger provisions are very important. And I think the key thing as far as the cable companies are concerned is that we have an opportunity to compete so that the rural telcos will allow us to the table.

At this point, they are just not prepared to negotiate with us. We have tried to talk with them about using joint fiber optics in some of these things. They are not prepared to discuss these issues, because, in their minds—as we read it at least—they think they are going to put us out of business.

So, if we can have an equal opportunity to be a competitor, then—and there is also the provisions for mergers and joint ventures and so on—I think the economics in those rural areas will dictate that there will be joint ventures. And that is how this type of technology will be brought to our customers.

The CHAIRMAN. But the list of States that you read, that was where there are small companies in financial trouble. But these problems would exist in any towns of less than 1,000 or less than 2,000 people, wherever they exist, the things you are talking about; is that not correct?

Mr. CUTLER. That is true.

The CHAIRMAN. Good.

Senator HOLLINGS. Thank you very much, Mr. Chairman.

The unregulated disruption that we just suffered from the police channel brings to mind the fact that the communications people—Mr. Neel, you talk about all those regulations—the communications people, the broadcasters themselves, ask for regulation as a result of just what occurred back in the twenties. And that is how we got the 1934 Act.

So when you list all the regulations that you put on the chart there, you ought to list on the other side, of course, the fact that they have got about a $5.5 billion guaranteed cash-flow. They spent about $600 million in taxes. They keep New York happy with about $1.6 billion in dividends, thereafter investing $1.7 billion in upgrading their equipment and going to fiber optic and otherwise. Leaving them anywhere from $1 billion to $1.6 billion excess profits.

That is one of the problems we have here at this particular level. They are rich. They are powerful. And there are several of the RBOC's that do not want any deregulation. They like it the way it is. And we have had a hard time getting this bill moving.

So, yes, the regulations were there over a 60-year period, but it had not really been too burdensome. If Senator Pressler and I are successful and we can get them to unbundle and join the field of competition, all of those regulations will go out of the window.

Specifically, Mr. Anstrom, what we had in cable was almost violent intermural. In fact, I refereed almost a fist fight in the back room and we came out here and voted 18 to 1 to regulate you folks. Thank heavens you are here. We had difficulty with the previous representative. [Laughter.]

Senator HOLLINGS. But I am delighted to see you. And I just have a lot of confidence in you. And I want to know what is the big, dramatic change that would cause us to deregulate further cable, other than the provision for the FCC to constantly oversee it?

In other words, yes, you got DBS, but it is, as Mr. Stillman has said, less than 500,000 homes, or one-half of 1 percent. You have to pay about $700. You have to pay an annual fee. And if I got DBS at my home, which I have entertained the thought, then I could not get the local channels, which is predominantly my interest, to find the local broadcast network programs.

So DBS has really not brought about any real competition.

None of the telephone companies have gotten into cable. There have been decisions—Bell Atlantic here, a year and a half ago, but they are not into it.

I am wondering why the dramatic change. We saw a good bill pass. In fact, it was the only override of President Bush's veto in his 4-year period. And we held tight to that particular position on a vote of 18 to 2 in this committee just last year.

Now, what is the big change, would you describe for us, that we have now competition going and everything else and the cable operators are suffering?

Mr. ANSTROM. Senator Hollings, I think several things have changed since the last time this committee and Congress looked at the question of regulating cable 3 years ago. First of all, cable prices have been cut 17 percent already as a result of the FCC regulations. So where we are starting from today is very different from the time that this Congress looked at this question.

Second, the world is changing very quickly.

Senator HOLLINGS. Oh, I know the world is changing. On the 17 percent, that was only—we gave you back half—or, rather, the FCC gave you back half. Get over on the House side and listen to Mr. Markey and the rest of them. They are really peeved at the FCC, after we tried to get it back in line to a reasonable profit, they gave you back half your profit. You did a pretty good job at the FCC level on that 17 percent.

Incidentally, Mr. Hassell was talking about the investments and the bank. And that is not the reaction of the bankers. In other words, debt financing by the cable industry has climbed to $10.8 billion in 1994, last year, from $6.9 billion in 1993, even while we had a credit crunch and the Federal Reserve Board was raising interest rates. That is not the way the financial market looks at it. They look at it as a good moneymaker and a good investment.

Mr. ANSTROM. Well, I would defer to Mr. Hassell on that question. I think he has probably a different view.

Senator HOLLINGS. I defer to the fact.

Mr. ANSTROM. And I would defer to the banker on those facts, Senator Hollings.

Senator HOLLINGS. This is a banker's facts, yes, sir, what I have given.

Go ahead.

Mr. ANSTROM. Well, again, I think if you look at the measures of capital availability, as Mr. Hassell indicated in his statement, it is very clear that lending, our access to the public markets, our access to the private markets, are markedly down from the pre-regulation period. And, in fact, as I indicated in my statement, the only independent analysis of this whole issue was conducted by the Economics Resource Group, which concluded, after looking at all of the available options for financing, that the cable industry faced real impediments to raising capital.

And I think, Senator Hollings, if I may, I think the other thing that has changed, in addition to the arrival of DBS, which we think is a real and vibrant competitor, is the question that is in front of this committee and that was suggested by your comments to my friend, Mr. Neel, here.

Which is, what you are expecting from our industry is much different than the world in 1992.

When you all passed the Cable Act in 1992, you kept in place the restrictions that kept the telephone companies out of our business. Those restrictions have now been struck down. The phone companies are coming into our marketplace.

And these are the original 800-pound gorillas, as I indicated. And in order to raise the capital to compete with them in terms of protecting our own business, as well as providing competition to them in their business, so that they do not act anti-competitively, we have to raise tens of billions of dollars. And that was not the situation in 1992.

And I think those things are very different.

With respect to the question of, well, the telephone companies are not providing service yet—I grew up, as I think you know, in the rural Midwest. And I sort of look at this as the way a variety store owner in a town looks when he hears that WalMart is buying parcels of land outside of his town to put in a WalMart store.

And it does not take WalMart to be in operation. The moment that variety store owner hears that WalMart is coming into town, he is going to do everything he can to earn his customers' trust and confidence. He is going to keep his prices reasonable. He is going to provide more service and more variety.

And the simple, legal authorization of the phone companies to get into this business is going to be a major constraining effect on the cable companies. If not, we are going to be out of business, Senator Hollings. I think that is the reality of it.

And of course, they are already there in our communities. They have a wire in 94 percent of the homes, every business. They are out there marketing and selling in every community today.

Senator HOLLINGS. Well, you are right. They are powerful. And like I said, it was intended that they have that monopoly, and they have given outstanding service. And one of the big problems we have is not to repeat our disaster with airline deregulation, whereby we have ruined them all, and now the regulated foreign airlines—KLM is taking over Northwest, and British Air, regulated, is taking over US Air and all the rest.

So we have come full circle. We try to learn from those experiences. But, specifically, you do not think we are going to pass a bill that allows the cable companies to buy an RBOC?

Mr. ANSTROM. I do not see that happening.

Senator HOLLINGS. I do not think that is going to happen either. Thank you, Mr. Chairman.

Mr. NEEL. Senator Hollings, very briefly. I am not sure I ever thought I would be in this room coming to the aid of the cable industry, but I think that it is important to point out that what you are trying to do with this legislation is to get people to invest, to build out these networks, to build the so-called information superhighway. It should not matter whether cable is taking its money and investing it in its networks or the telephone companies.

Why do you want to be constantly and terminally refereeing this kind of investment contest?

If you break down these rules, if you minimize regulation, you will create dramatic investment, both in the cable industry and in the telephone industry. So the issue of whether one company is earning more than another company should not even be a factor in this debate, going forward.

Senator HOLLINGS. Of course, the object is not to referee the fight; it is to try to develop competition. And that is exactly the thrust of Senator Pressler's bill, my bill, and everyone else's. The one under consideration is to try to develop competition, where you are bringing in a monopolistic entity, like an RBOC, that is determined—and there is no question about our experience here for the past 3 or 4 years—they are determined to extend that monopoly.

And how to put a bridle on that animal is a very difficult thing, but we are going to do our best.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Hassell, tell me a bit about the Bank of New York. I have not heard of it before.

Mr. HASSELL. The Bank of New York is the oldest bank in the United States.

Senator PACKWOOD. Is it a merchant bank?

Mr. HASSELL. No; it is a commercial bank.

Senator PACKWOOD. Is it?

Mr. HASSELL. It was founded by Alexander Hamilton. So we have been around a long time. And in this particular industry, as I said in my statement, we made some of the very early loans to the founding companies in these businesses.

Senator PACKWOOD. I was rather impressed with how deeply involved you are in telephone, cable and whatnot. Now, I wonder, there are lies, damn lies, and statistics. And I cannot make heads or tails out of two what appear to be conflicting statements.

Mr. Stillman says, since the Cable Act passed in October 1992, the Kagen Index of cable stocks has increased by 47.8 percent. Over the same period, the Standard & Poor 500 increased only 11.2. You say the value of cable stocks dropped over 6 percent from September 1993 to today, while the Standard & Poor index rose by 6 percent.

Now, I realize you are slightly a year off. But are those two statements compatible?

Mr. HASSELL. I believe they are. We went back to look at September 1993, when the regulation was enacted, and looked at the composite of public cable companies. And that is the decline in their stock value, while the S&P is, as I stated, it rose during that time period.

Senator PACKWOOD. Is Mr. Stillman taking an artificial base period, then, going back a year earlier?

Mr. HASSELL. I am not sure how Mr. Stillman came up with his numbers.

Senator PACKWOOD. Well, can you tell me, Mr. Stillman, did you go back a year earlier to get that higher base period? Had you measured from October 1993, would you have the same figures as Mr. Hassell does?

Mr. STILLMAN. I am not certain what the figures would be from 1993. The reason we relied on the numbers from 1992, because that is the date of passage of the Act. And we know how the markets tend to respond to what Congress does in passing legislation, not only simply when the regulations are put forth by the Commission go into effect.

I would also point out that the statistics we have relied on are the basic statistics that the industry uses—the industry standard, which is the numbers from Paul Kagen Associates.

Senator PACKWOOD. I am not sure I still understand.

Mr. Neel, let me ask. You also represent the Bells, in addition to everybody else, do you not?

Mr. NEEL. That is correct.

Senator PACKWOOD. Let me see if I understand the import——

Mr. NEEL. The 180-pound lightweights. [Laughter.]

Senator PACKWOOD. They are like yourself. [Laughter.]

Mr. NEEL. Whatever.

Senator PACKWOOD. I want to make sure I understand Judge Greene's action on Friday that was reported in the press. I have not read his decision. As I read it, the Bells were already winning court cases to get into cable. If I read his decision correctly, he is saying fine to Bell Atlantic, but it looks like to everybody, go ahead, you may program, you may carry, and you can also do it interLATA. Do I read it right?

Mr. NEEL. I think that is right. I have not studied the decision, but I believe the problem addressed the issue of a telephone company taking down a signal off a satellite for distribution.

Senator PACKWOOD. Right.

Mr. NEEL. And that represented a de facto interLATA transmission.

Senator PACKWOOD. And, in essence, now, the telephone companies can get into cable nationwide?

Mr. NEEL. We believe, by virtue of the court decisions, they can do that. By virtue of Judge Greene's decision on satellite transmissions, they now have a way to take down the signal from the headend.

Senator PACKWOOD. Right.

Mr. NEEL. There are other regulatory problems in the making, and some, unfortunately, could be created by the bill that you are drafting.

Senator PACKWOOD. I agree.

Mr. NEEL. But, yes. The answer is essentially.

Senator PACKWOOD. OK. And, again, you have got a three-Bell consortium that has hired Howard Stringer from CBS, and it looks like they are practically ready to program. This is not in the distant future. It is next month as best I can tell. Have I got that roughly right?

Mr. NEEL. Well, I am not sure they are quite there yet. I am not totally familiar with their business. But they have certainly got a lot of activity going. There is a lot of creativity at work. Howard Stringer is one of the aces. And they will be players. I do not think they are ready quite yet to do that.

Senator PACKWOOD. Although they can buy programming from anybody else?

Mr. NEEL. That is correct.

Senator PACKWOOD. They do not have to wait to do it themselves.

Now, Mr. Anstrom, let me ask you this. I am going to assume that—and tell me if I am wrong—that every house that is connected to cable probably has a telephone. There may be some that have cable and no telephones. It would be an unusual house, would it not?

Mr. ANSTROM. I will take your assumption, although one of the more interesting facts is that there are more homes with TV sets than telephones in America. But, yes, I think that is right.

Senator PACKWOOD. Well, that does not surprise me. You just mean more sets.

Mr. ANSTROM. Right.

Senator PACKWOOD. Yes, they would rather watch than talk. That part I understand.

Therefore, you, in essence, are going to be faced with very effective competition not next year, but in a few months. If I understand—and Mr. Neel can correct me on this—if I understand the technology, the copper wire into the home can carry cable. You do not have to do any great restructuring of the wire to the home. You may be doing some fiber optics to the neighborhood, but, to the home, you can get in with cable now, can you not?

Mr. NEEL. The current generation of what they call twisted copper wire, it would be difficult to transmit multichannel services like traditional cable systems. What you could do is basically drop a coaxial cable from the curb into the house. And that is essentially the kind of hybrid networks that the telephone companies would likely be doing in the near future.

But it would be difficult with just twisted copper telephone wire right now to efficiently deliver multichannel video, such as a cable operator.

Senator PACKWOOD. OK. So you go to a coaxial cable from the telephone pole to the house?

Mr. NEEL. Right. Perhaps off a fiber optic trunk.

Senator PACKWOOD. Right. That I understand. It may or may not go to the telephone pole. It may go to the neighborhood.

But it is not a difficult technical problem, then, to do this rewiring?

Mr. NEEL. No. But it does require significant investment.

Senator PACKWOOD. Right.

Mr. NEEL. Because you have got to lay all the fiber into the neighborhood. And then you have got to lay new coaxial in, or develop agreements with cable to do that. It is costly and time consuming. And that makes it more difficult to begin, for instance, under your scenario, tomorrow, for any telephone company to begin providing cable.

Senator PACKWOOD. I thought the telephone companies were going ahead with their conversion over to fiber optics anyway.

Mr. NEEL. Sure. It is important to do that regardless, because it is new technology, it is just a more elegant equipment to provide all kinds of signals. And it can be used for all kinds of things other than just telephone service.

Senator PACKWOOD. Now, Mr. Anstrom, let me ask you this.

The test at the moment on competition is 50 percent of the homes and 15 percent of the customers. But is it 15 percent of your customers or is it—let us say you have got 1,000 homes and you have got 60 percent penetration. You are covering 60. The phone company very quickly can meet the 50 percent potential test. Is the 15 percent of your 500 customers or is 15 percent of 1,000 potential customers?

Mr. ANSTROM. The latter, Senator Packwood. The homes in the franchise area.

Senator PACKWOOD. And they have to sign up; it is not that they could sign up; it is not that it is available?

Before you have effective competition, they would then have to have 150 customers on a 1,000-customer base?

Mr. ANSTROM. Exactly.

Senator PACKWOOD. Some of which, in all likelihood, are going to be some of your customers?

Mr. ANSTROM. If you listen to the telephone companies, they certainly think so. Yes, sir.

Senator PACKWOOD. Do you want to comment on that, Mr. Neel?

Mr. NEEL. Well, we certainly support this effort to get rid of this arbitrary 15 percent designation. It is no better than that. And we hope we can win more than 15 percent of their customers. We fully expect them to be aggressively getting our customers, because the fiber optic technology you mention—not only can the telephone companies use this for other services, but cable systems which are aggressively laying fiber as well can use that same system to provide telephone services. Which is exactly what you want.

So those kinds of technological parities exist now. The 15 percent is highly arbitrary. We would not want it applied to our services any more than cable would to theirs.

Senator PACKWOOD. Is the current cable wire that goes into the house capable of carrying telephone?

Mr. ANSTROM. Yes, sir.

Senator PACKWOOD. You do not have to do any extraordinary conversion that the phone companies would have to do to carry cable?

Mr. ANSTROM. To carry telephone service?

Senator PACKWOOD. Right.

Mr. ANSTROM. We have some conversion involved. Again, in the laboratory, we can deliver telephone service over that last mile of coaxial cable. As a practical matter, in places where our companies are doing that, particularly, I might point out, in a deregulated environment like Great Britain, we are using a twisted copper pair to deliver the last telephone voice. But with the same kind of upgrades——

Senator PACKWOOD. Are you adding an additional wire to carry the telephone or what?

Mr. ANSTROM. Yes, Senator Packwood. The model now in Great Britain, which is really the leader because of the kind of environment that they have created there, is both the phone companies and the cable companies are going to be build the same kind of plant, which is fiber optics deep into the neighborhoods, and, at least for now, a coaxial cable and a twisted copper pair to provide both telephone and video services.

I would tell you that Cable Labs, our R&D consortium, is actively involved in an RFP process, however, which we think will lead to major telephone suppliers telling us how to deliver voice over that coaxial last mile.

Senator PACKWOOD. And my last question is to Mr. Neel.

You think you will get rid of your twisted copper and simply go to a coaxial cable, rather than just attempting to lay the equivalent of a cable in alongside your twisted copper?

Mr. NEEL. I think there will be interim steps to provide full service. We will start, just as Decker said, with a combination of twisted copper and coaxial. In some cases, there will be fiber running right up into the homes—in perhaps new developments where it is economically feasible. There are all kinds of ways to do it.

I would point out one thing. Even though the technology is comparable, and as Decker said, they could very quickly move into telephony, the rules that will govern the sale of those services and the hole management of those networks are vastly skewed toward burdens for the telephone companies and very few restrictions for the cable companies.

We applaud them. We simply think there ought to be de-regulatory parity, to allow us both to compete on the same terms.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. I am going in the order of arrival here.

Senator BURNS. Thank you very much, Mr. Chairman.

STATEMENT OF SENATOR BURNS

I would just ask that my statement be part of the record. And I do not have very many questions, because we have been down this road so many times that it is unreal. I never will forget, way back in 1989, when we sort of froze the folks here. And, Roy, you were around at that time.

[The prepared statement of Senator Burns follows:]

PREPARED STATEMENT OF SENATOR BURNS

Mr. Chairman, I want to take this opportunity to thank you and Senator Hollings for having this hearing this morning on Telecommunications Policy Reform to discuss the important issues of Cable Rate Deregulation, Broadcast Ownership and Foreign Ownership.

These issues, while perhaps new to any legislation to reform our nation's telecommunications policy, have been discussed extensively over the past few years. I'm glad to see that they're being discussed today because all three are important elements to truly comprehensive telecommunications reform.

Chairman Pressler, Senator Hollings and the other members of the Committee and our staffs have been working very hard to arrive at legislation that has as its benchmark competition and deregulation—so that consumers will truly benefit through lower prices, more and better choices and an improved standard of quality. These are the elements that I will use to evaluate any telecommunications legislation that winds its way through the halls of Congress. And these are the elements that I will consider when listening to the testimony of our distinguished panelists in front of us today.

I am no stranger to the debate on cable rate regulation. In 1992, I was a very vocal opponent of the rate regulation provisions in the Cable Act. I thought it was bad policy then and I think it's still bad policy today, perhaps even more so in the face of increased competition for telecommunications services. At a time when we should have encouraged cable companies to enhance their networks and provide additional, new programming, Congress chose instead to tie cable's hands behind its back by rolling back rates and providing regulatory uncertainty.

Now, as we look to allowing full competition for all telecommunications services, some would suggest that we keep cable's hands tied through continued rate regulation.

I disagree. Only through deregulation can we achieve true competition.

In the broadcast marketplace, broadcasters are operating under archaic rules that better suited the 1950's than the 1990's. As we quickly approach the 21st century, it is time that we reevaluate regulations that so strictly govern the broadcast industry. Whether it be cable/television cross-ownership, national ownership limits for radio and TV or the newspaper/broadcast cross-ownership restrictions, yesterday's regulations may not be appropriate for tomorrow's broadcasting marketplace.

It is clear that the broadcast environment today is the most competitive it's ever been and every indication is that this trend will continue. In this new climate, competition is performing today what regulations provided in the past...diversity, localism and preservation of free over-the-air broadcasting that serves the public interest at large. But we must eliminate unnecessary regulations imposed on the broadcast industry because, if we don't, competition will only take us so far.

As we look to reform our nation's telecommunications policy, we must also recognize that the world in which we now live has changed substantially over the past several years. Thanks to technological advances, people from all over the world are now within reach of each other.

For those of us who cherish the rural nature of the states in which we live, we look to telecommunications to allow us to compete in the global economy, learn at the best educational institutions and receive the most up-to-date medical advice that individuals from around the world can offer...all without leaving our own backyards.

But we cannot expect to have the world opened up to us if, at the same time, we continue to close our markets to countries wanting to compete in the United States. It is important that we provide free market access to other nations If we expect them to open their markets to our own businesses. This market access and competition, if reciprocal, is vital to the economic development of the United States and other nations competing in the global economy.

Competition and deregulation—the hallmarks of good legislation. I look forward to hearing from our panelists today on how we can use these principles to establish the National Information infrastructure to move America forward. Thank you, Mr. Chairman.

Senator BURNS. Mr. Stillman, have you ever seen a regulatory bill that you did not like? [Laughter.]

Mr. STILLMAN. Well, a regulatory bill that does not have as one of its goals to bring competition so the regulation can ultimately go away. That is a regulatory bill we absolutely dislike.

Senator BURNS. Then you would oppose the repeal of the 1992 Act?

Mr. STILLMAN. We do. Well, we oppose repeal of the Act until there is actual competition. The idea that you can measure competition by simply having something available is, we believe, a mistake. Because until consumers are actually subscribing to that alternative, you have no evidence that it is viewed as the public as a comparable service.

Senator BURNS. What I fail to understand is, in a regulatory environment, it has been my experience that you never did see any kind of viable competition ever come into an area where you have a regulatory environment.

Mr. STILLMAN. Well, Mr. Neel and others would certainly say that, under their extreme regulatory environment, they are facing lots of competition from competitive access providers and the like. We would argue with their characterization of how much competition there is. But, nonetheless, competition does seem to be developing both in the cable industry and in the telephone industry.

The question is not whether it is developing; the question is whether there is enough competition so that it can act to constrain prices, like a competitive market otherwise would.

Senator BURNS. Well, I understand that. But what we have got here between what Mr. Neel represents and Mr. Anstrom represents is an area where one is regulated and the other one is not in that specific area. So you are just allowing a lot of folks to do a lot of nibbling around the edges that are taking away the base and the ability for the telephone companies to get in the business.

I feel very strongly that we have to repeal the Cable Act and to open that up, and also make the entry regulations the same for everybody who wants into the business.

And Mr. Hassell over there is quite right in his figures.

In other words, we have seen the capital dry up for expansion of new programming and of new things going on whenever we reregulate. Because I was one of those folks that did not want to see that regulation go into effect in the first place.

Mr. Neel, tell me about your deployment of your fiber, and then your fiber/coaxial combination. I know our co-ops and rural telephones have been very active in deploying fiber. They operate outside the regulatory environment. I want to know what progress the telephone companies have made in this.

Mr. NEEL. Well, there are more than 1,000 telephone companies that belong to our association, and a couple of hundred more that do not. And all of them have different timetables, because they all have different regulatory environments, they all have different financial situations. As we said earlier, they will move as quickly as they can, depending on their ability to invest.

This is one area where you can clearly stimulate investment in places like Montana and throughout the country in rural areas. Because if the telephone companies and the cable companies do not have the ability to invest in new plant and infrastructure that is costly and takes quite a while to get a return on that investment, they are not going to be able to do it.

It is not going to happen by magic. The taxpayers are not going to be able to do it. So these private companies have to do it.

All the companies are doing it differently. Some will go early with twisted copper for telephone service, and coaxial for video. Some may even use some hybrid satellite technologies.

The terrific thing about all of this is that—and to dispute Mr. Stillman somewhat—the availability of competition is very important, because, frankly, with DBS, with telephone companies potentially, and cable, and all other kinds of providers, if someone does gouge customers, if someone does abuse their market, there are very few entry barriers now that would allow that to come in.

So it is happening all across the board. Regulation does need to come down to free up investment from all these players.

Senator BURNS. Tell me about the role of the State PUC's.

Mr. NEEL. Well, it is critical. Every State governs the provision of local telephone service. There may be one or two that are involved in cable. But the State PUC's govern the way the rates are set, the way service is handled.

Most of them—40 of them—have proceedings under way to blow open the local telephone marketplace, to insert competition rapidly. Six are wide open—virtually no limits whatsoever to competition. So they have a critical role for the provision of local service. That is important in many respects.

It is important for competitors to be able to get into telephony. And it is important for the telephone companies to be relieved from some things, such as severe rate-of-return, cost allocation regulation, in order for the phone companies to be able to get into these other kinds of services, to compete.

Senator BURNS. Mr. Anstrom, do you want to comment on that?

Mr. ANSTROM. Well, I think that the reality—with respect to the State PUC question—I think that obviously they have a very critical role in terms of the regulation of telecommunication services. In some cases, they do regulate cable companies, in terms of cable regulation. And I certainly agree with Roy that, again, a flexible regulatory environment, that acknowledges this very quick development of competition—competition that has developed in part because of the 1992 Cable Act and the program access provisions in the Cable Act—is changing this world, again, very quickly for all of our companies.

Senator BURNS. Mr. Cutler, you mentioned about real competition from DBS and the direct channels. Do you really think that they can be really considered, because they cannot get access to local programming, that they are really a strong competitor right now, a strong enough competitor to be acknowledged to your rural cable companies?

Mr. CUTLER. The answer is yes, Senator Burns. Most of our customers have access to the off-the-airs by a simple antenna. And that is how they were receiving their television before the cable was built. So they all have the networks and the public cable TV available over the air. And so that is available with an antenna and an A/B switch, and they have what they need.

Senator BURNS. I think Senator Gorton has a question for you, and I am not going to—we were sort of talking about that—and I am going to let him handle that. But I thank you for coming today.

That is all the questions I have.

The CHAIRMAN. Senator Stevens.

Senator STEVENS. Mr. Chairman, I merely comment that Alaska really is not in the footprint, as I understand it, of DBS. Other than that, as Senator Burns said, I think we have been down this trail before.

I do not have any questions today.

The CHAIRMAN. Senator Ford.

Senator FORD. I do not want to be called a ditto head, but I am going to agree with my friend from Alaska. [Laughter.]

Senator FORD. We have been down this road before. And I think I understand it.

Let me just ask one question. Mr. Anstrom, tell me about this 18-inch dish. I mean what can it do? I see a lot of places you can buy it. You can buy it at lots of places.

REA's sell it. Maybe 700 to 800 they have ordered, and now they are ordering that many more.

In my part of the country, you just do not get cable.

Mr. ANSTROM. Right.

Senator FORD. And then, when you get a dish, as we have been through this, then you scramble the dish. And so we cannot do these things.

Tell me about this little 18-inch sucker out there. [Laughter.]

Mr. ANSTROM. It sounds like I am ready to make a sale here, Senator Ford.

Senator FORD. No, not if you scramble the damn thing. [Laughter.]

Mr. ANSTROM. I am glad you have asked that question.

Because I think that one of the things that has clearly changed very dramatically in the last year has been the advent of direct broadcast satellite services. Currently, two major companies are now providing high-powered services from a satellite, which allows a customer only to need an 18-inch dish, rather than the big birdbath that you and Senator Rockefeller and others are familiar with, in areas where cable has not been available.

That 18-inch dish and that high-powered satellite is capable of delivering 150 channels of digital television, absolutely crystal, perfect clear pictures. And that provider—in this case the principal one being Direct TV, which is a subsidiary of General Motors—has available every single program that the local cable system offers, because of the program access provisions of the 1992 Act. They have CNN, Nickelodeon and everything else. They have an absolute right to deliver that.

And I would be clear with this committee. We are not asking this committee to change that provision of the Cable Act. Those are retailed now throughout the continental United States—Senator Stevens is right that Alaska and Hawaii currently do not have a footprint for this satellite—but they are being retailed—you can go to any Circuit City store here in the Washington area and buy one of those dishes. You can go to Sears.

The National Rural Telecommunications Cooperative, an affiliate of the REA's, makes these available. And in fact, they announced last week that they will help finance the cost of this dish for rural customers in REA districts.

The price of that dish currently is $699. That is a steep bill for some people. But I think one of the things that is important, as you all well know, the price of these products are going to come down dramatically. The price of cellular phones came down 55 percent in 2 years. The price of the VCR came down 35 percent in 2 years.

Last week, again, at the satellite convention in Las Vegas, Hughes announced that they are authorizing three new manufacturers to begin manufacturing dishes next year, and that the prices of those dishes will probably come down to $399 next year.

And if you look at a cable system offering, on average, 40 channels, against 150-channel competitor that has all the programming we have and a low retail price that increasingly will be financed by the distributor, I think that is competition, Senator.

Senator FORD. What will it cost me as a customer to purchase an 18-inch dish, other than the $699? I mean do I pay the satellite owner? How much? And can he scramble all 150 channels? So when I buy the dish, we go back to the same problem we had with the bathtub.

Mr. ANSTROM. You would still pay a fee to the distributor of those programs. There are whole packages of programs offered by the distributors. You could buy a small package of programs for as little as $5.95 a month. You could buy the whole load of 150 channels.

Senator FORD. Regardless of what I do, it is still controlled by somebody else?

Mr. ANSTROM. Yes. Typically, in the rural areas, that is distributed through the local REA now.

Senator ROCKEFELLER. Mr. Chairman, if I could just interject to the Senator from Kentucky.

You pay a substantial amount for DBS. And then for 30 days you get all kinds of things free. After 30 days, all of a sudden the things do not become free. And then they call you up and they say, well, now if you want to see these things, you are going to have to pay $395 or $495 dollars.

So the rules change 30 days after you get the set.

Senator FORD. I have been through this, and that is what we had with—we have different kinds of States. We have some that have vast territories and they are sparsely settled. We have mountain areas where the cables will not go. And then we try to work out something to get them the television, and then they are prevented from receiving it because somebody else owns the end product. And so we are scrambled.

And now we are seeing the little 18-inch dish that does all these things. It is just like you get no interest for the first 30 days, but then, after 30 days, wham, the interest goes up to the double digits. So it is not as sweet and light out there. And I am looking at rural coverage more so. The money is in the urban areas. But you have got the small operator and others out there that have—they will never be able to compete as long as you can have an 18-inch dish.

I thank you, Mr. Chairman.

The CHAIRMAN. Senator Lott.

Senator LOTT. Thank you, Mr. Chairman. I just want to thank the panel for being here this morning. It has been a very interesting presentation. But, in the interest of hearing the next two panels, I am going to defer my questions, too.

The CHAIRMAN. Senator Ashcroft.

Senator ASHCROFT. I subscribe to the wisdom of Senator Lott.

The CHAIRMAN. Senator Dorgan.

He has departed.

Senator GORTON.

Senator GORTON. Mr. Cutler, I just have one question or one clarification. I just wanted to get it straight. You want us to deregulate the prices you can charge to your customers, but further regulate the prices that your suppliers can charge you?

Mr. CUTLER. Well, you could take it that way.

Senator GORTON. I do take it that way. [Laughter.]

Mr. CUTLER. The issue is this, sir. What happened was that we had our rates to our customers regulated, but there was no regulation on our cost, and so our cost had gone up dramatically, particularly our programming, which is our bread and butter. That is the food for the restaurants. We have to have that in order to provide the product that the customer wants. That was not regulated. So our costs went up and our prices were regulated.

Now, what we are saying is, with regard to the price for the programming, there has always been this wide difference between what the large providers pay and what we the small providers pay. Now we have DBS in our back yard. That is the large provider. They are buying this at the low rates, and so we will not be able to compete over time and provide the additional programming unless we are given the opportunity to buy the programming at those same competitive rates. We do not want any advantage, we just want to be able to buy it at the same rates as the larger providers.

Senator GORTON. But when it comes right down to it, you want the Government to regulate, essentially, the prices you can be charged, but you do not want the Government interfering in what you can charge to your customers.

Mr. CUTLER. If the programmers would be controlled by antitrust, we could force them to lower the rates. But unfortunately, programming is not covered by antitrust and so they have been able to take advantage of the small cable operators. The bread producer, the one that sells the buns at the hamburger stand, cannot charge more for the local hamburger stand than they can for McDonalds. But unfortunately, in cable the programmers, the HBO's the Time Warner's, the Viacom's, are charging 54 percent more to us, the small hamburger stand, than they are to McDonalds,

Wendy's, Burger King, and those fellows, and therefore we cannot compete.

Mr. ANSTROM. Senator, if I could just briefly add for the record, if I might, with respect to the people I represent, which includes the cable program networks, this is something that Mr. Cutler and I strongly disagree on.

Senator GORTON. I suspect you do.

Mr. ANSTROM. And I would say to the committee, there is a process created by the 1992 Act that allows complaints to be filed at the FCC and for these kinds of business disagreements to be hammered out there, which I think is the appropriate mechanism.

Senator GORTON. Thank you, Mr. Chairman. That is all I have.

The CHAIRMAN. Senator Kerry has departed. Senator Breaux.

Senator BREAUX. Thank you, Mr. Chairman.

Mr. Angstrom, I guess the question is can you get growth in a regulated industry? And it seems like an awful lot of people that want to get into your business, even though you have got rate regulation on the services that you offer. It seems like there is competition. More and more people think that while you are regulated, it is still a good thing to get into and they are knocking down your door to get into your business, even though you have to follow rate regulation. I guess your argument is "Look, we need deregulation in order to be able to compete, in order to be able to do more things." But there are a lot of people who think the situation is just fine, and they would jump into it tomorrow if they had the opportunity to under the existing conditions, without the control of your rates.

Mr. ANSTROM. Well, of course, I think the critical difference, Senator Breaux, is that in that case the competitors are not subject to the kind of regulatory restrictions that we are. And, for example, the DBS services,

I think it is important to underscore, are not subject to any of the regulations that affect, putting aside pricing, the way in which we can package and market our services. In many ways those requirements are as onerous or more difficult for us than the pricing restrictions. And of course, I think, as Mr. Neel's testimony suggests, if they get into the cable business, they certainly do not think that they are going to be subject to the Cable Act requirements in terms of pricing regulation, and in fact they would not be under the terms of the Cable Act.

We think this is a good business. We want to stay in it. We are committed for the long term.

Senator BREAUX. Well, is it just the larger companies that have done very well, Time Warner and Cox Cable, that have done extremely well financially under the existing rate regulation system?

Mr. ANSTROM. Well again, I do not think that anyone has done extremely well, Senator Breaux, under these regulations. I think the most important fact, here, is that for the first time in the history of our industry, even though subscriber growth did occur under regulation, the revenues for our industry did not increase from 1993 to 1994. And I think perhaps the most telling indication of the impact of these rules is that 14 companies—and these are not small companies, these are large to midsized companies—have already voted with their feet, and they have left the cable industry, either merging or consolidating with other companies. And I think as you look at the twin forces of new competition and restrictive regulation, many of these companies are very concerned about how they are going to make a go of it.

Even the larger companies, I think, while they certainly generate some cashflow, are, as I think Mr. Hassell has testified, encountering real problems in terms of raising capital in the capital markets.

Senator BREAUX. Are you satisfied with continued rate regulation on the lower tier?

Mr. ANSTROM. I have said privately to many members of this committee, and I would say publicly today, that we could accept continued regulation of the broadcast basic tier, which in many cases provides a lifeline service for people; for example, who subscribe to direct broadcast satellite. And it provides an antenna service for many people who do not receive over-the-air broadcasting very clearly.

Senator BREAUX. What would prevent, then, a cable company from pushing everything up into the upper tier or expanded tier and just having maybe one station on basic tier?

Mr. ANSTROM. The Cable Act requires us, as you know, not only to carry local broadcast signals, but also to create a package in which those are included. Most cable systems have already created two packages of service. One is a broadcast basic tier of the locally retransmitted broadcast signals. The other package is the package of services that include the popular cable networks. And so the Cable Act itself has really already stimulated the development of those two packages in most systems in the country.

Senator BREAUX. Roy, can telephone companies compete with the cable companies on the basis of price for services? I think your testimony talked in terms of telephone companies must do a lot of rewiring in order to compete in the cable business and that would be very expensive, in fact.

Mr. NEEL. Our companies are very competent; they can compete. A number of telephone companies already provide cable. These are very small rural companies that operate under the rural exemption, and they do so nicely. They do so without burdensome separate subsidiary requirements, and this is an important point, that even if these phone companies are allowed to get into cable under the court action and under what this legislation may do, you are still going to mandate fairly severe separate subsidiary requirements. There are requirements that telephone companies get, what are known as 214 waivers at the FCC for video carriage, and the draft that we have seen earlier even delays entry for 1 year, without delaying entries for any of the competitors into telephony.

So while we think long-term our companies can compete, if the rules are fair and if there is a parity. There should be the least possible regulation, and it should be the same for all players. So yeah, we think we can compete.

Senator BREAUX. Is it necessary for the phone companies to get rate regulation relief in the cable industry before you would get into it, or not?

Mr. NEEL. Is it necessary for us to get rate regulation for telephone services, before you would want to get into that business. Can you get into that business under the existing rate regulation structure for cable?

Mr. NEEL. Yes. Yes.

Senator BREAUX. Thank you, Mr. Chairman.

Mr. STILLMAN. May I just add a point, Senator? There has been a lot of discussion of this issue of regulating the basic care and what that would mean. It sounds like the cable industry wants the Congress to regulate only the thing that most customers can get for free from another source, and they do not want regulation of those unique programming sources like CNN and ESPN and MTV and others that are the things that drive the purchase decision of the cable consumer.

Senator BREAUX. Are those not things that would be available through other markets or from other avenues?

Mr. STILLMAN. Well, they may be available from other markets. All this discussion of DBS, I do not believe they have even manufactured a million dishes yet in this country. There are 62 million cable subscribers in this country. They pass virtually every home in the country. So it is sort of apples and oranges.

Our concern is not to keep the cable industry under regulation any longer than absolutely necessary to protect consumers from monopoly abuses, but we believe we do need rules for this transition, and nobody can say exactly how long the transition is going to take.

Senator BREAUX. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Hutchison.

Senator HUTCHISON. Thank you, Mr. Chairman. I appreciate very much your holding these hearings, because I believe that there was a great mistake made by Congress in the regulation of cable companies, and I think it has caused a sea change in the industry, and I hope that we can correct some of those issues while we also open deregulation in the whole telecommunications industry.

I have been working to try to make sure that all of the entities that might come online would have a level playing field. And I have also been trying to protect the cities' interests in their rights of way usage. I wanted to ask Mr. Anstrom a question regarding that issue. I believe that telecom services are subject to telecom right-of-way authority and cable is subject to cable franchise authority. Do you agree with that?

Mr. ANSTROM. In terms of the current laws that operate now?

Senator HUTCHISON. Well, no, as we move into the new era where we will continue to have those separated lines.

Mr. ANSTROM. Well, certainly with respect to cable we would certainly, in terms of our cable business, remain subject to regulation under our local franchising authorities. With respect to telecommunications services, I think, as Mr. Neel has generally indicated, most of the regulation of telecommunications services comes from the State PUC level, with, as I understand it, some minimal right-of-way judgments about street cuts and things with respect to the telephone company's activities in the community. That is my understanding of the current situation in most States today.

Senator HUTCHISON. Well, in most States. I know it does differ, but generally there is a delegated authority for rights of way protection. But do you agree that the telecom units that come in, even as we deregulate and have new technologies, should remain with telecom right-of-way, and cable franchising should remain as cable franchising?

Mr. ANSTROM. In general, if I can answer your question this way, and if I am not being responsive, please ask me again, but we have no problem with the general rule of parity that cable services offered by the cable company and the phone company; and telephone services offered by the cable company and the phone company should generally be handled in the same way. I will say, Senator Hutchison, that we have grave reservations about anything that would allow the local municipality to extend its regulatory jurisdiction beyond its local cable franchising, in terms of the quality of services or issuing new franchises or those kinds of things, which I think there is an abundant record in the video business, provides a lot of opportunity for municipal mischief, frankly.

Senator HUTCHISON. Well, thank you. I just want to make sure that everybody has a level playing field as we come into this new era, and I want to leave as much regulation out of it as we possibly can, but I also want to make sure that one entity does not come in and pay all the fees and lay all the rights-of-way and then a competitor comes in and does not have to do that and therefore has lower costs, and it would not be fair.

Mr. ANSTROM. We understand that.

Senator HUTCHISON. So as we go through this we need to keep the level playing field.

Mr. ANSTROM. Absolutely.

Senator HUTCHISON. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Snowe.

Senator SNOWE. Thank you, Mr. Chairman. It is interesting to listen to the testimony here this morning because it is clear there are some contradictions in terms of whether or not there is competition, no competition, or you allow competition or not, and Mr. Neel, you mentioned in your testimony that one of the myths is that Federal legislation is not necessary to allow cable to compete against local telephones. And in fact, is that right?

Mr. NEEL. No, actually, the reverse of that I think is what I said. Legislation is not necessary to allow telephone companies into cable, because we have won these court victories. I may have misheard you.

Senator SNOWE. No, the Federal legislation is needed to allow the cable industry to compete against the local exchange industry is in number 6.

Mr. NEEL. Oh, yes, I am sorry. That is correct.

Senator SNOWE. And you made reference to Decker Anstrom and a study of competitive barriers in States indicating that 28 of the 50 States have removed some of the barriers to competition. Where they removed the barriers, was it in areas where there could be effective competition?

Mr. NEEL. Well, each of the States have used different criteria, and it is our expectation that all 50 States will have opened up these markets effectively to allow not only the cable companies into the telephone business, but every other kinds of competitor, as well. I do not think there have been problems associated with doing that.

Senator SNOWE. So in other words, the cable companies have gone into areas where they think it could be profitable for them in areas in which the States have opened up to competition?

Mr. NEEL. I suspect that is right.

Senator SNOWE. In nonresidential markets?

Mr. NEEL. Sure. I would expect that would be correct.

Most of the competition has been for business customers, so far. Very little, in fact virtually no competition for residential telephone.

Senator SNOWE. Then are you saying then that it will not be competition in the residential markets if we were to lift the barriers for rate regulations?

Mr. NEEL. Well, this is an enormous problem, and I am sure you are going to get into this later in the year on issues of universal telephone service. There are parts of this country where competition for residential telephone service will be a long time coming. In fact, cable offers probably the best opportunity for facilities-based competition, because they have networks. So they may be their early on. But much of the talk and the cry for opening up the local telephone market and let us in relates to coming in and taking away high volume, very profitable, business customers, and it is going to be an issue of concern for a long time how you protect those telephone customers in rural areas where there will be very little competition.

Senator SNOWE. See, Mr. Anstrom, my concern is, and I would like to have you respond to it, is on this issue, because I voted in 1992 for the Cable Act, and I hear what you are saying this morning in terms of the impact since that time in terms of decline of profitability, although I understand, and decline of revenues, although I understand that is also a matter of question. The real issue is whether or not competition will exist in those areas.

My concern is, and I do happen to represent a rural State for the most part, but even in areas where NYNEX, for example, could compete in cable programming, that will be a few years before they are on line, and that is the most urban area in our State. So what is to ensure that we will not have protection against increased prices if we repeal the Act of 1992? And I think that is essentially the concern of many of us on this committee who represent rural areas, is exactly what is going to happen?

Mr. ANSTROM. And as I suggested in my opening statement, our industry is very sensitive to that concern. We know that this is a controversial issue, and has been for some number of years. I think I would answer your question several ways. First of all, as I suggested in discussing with Senator Ford,

I think it would be a mistake, as Mr. Stillman has suggested, to underestimate the competitive impact of DBS. As Mr. Cutler said, he views this as a real competitive threat in rural cable systems in South Dakota today. And as those dish prices come down, and they will in 1996, that is a very potent competitor, particularly as the price of those dishes is financed.

Beyond that, as I suggested earlier, I think that any cable company in this interim period, from the time that they are authorized now to provide telephone service, and the telephone companies are authorized to provide cable service, to the time they actually turn on their plant, that a cable company has an enormous constraint, and it is this: that if you know that the 800 pound gorilla, NYNEX in this case, is getting ready to provide cable service, the last thing you are going to do is to alienate your customers. That cable company is going to have to work hard to win their loyalty and trust, to do a better job on customer service, to offer better products, and if they do not, they are writing a prescription for going out of business. And I cannot think of a better constraint than that, and that is what is different than 1992. The 1992 Act specifically kept the restriction on the phone companies, and DBS was a dream, not a reality.

Senator SNOWE. But the average price of a DBS is what, $700? What do you expect it would be in a couple of years?

Mr. ANSTROM. Well, next year, based on what we heard in the satellite convention last week in Las Vegas, that price will be down to $399, and particularly in rural areas, addressing your specific concern, the REA's have already indicated that they intend to help underwrite the cost of that for their customers. I think you will find other distributors doing the same thing.

Senator SNOWE. You mentioned the definition of effective competition. Could that not be a way of which to address your problems in terms of the percentage of subscribers, from 15 percent, to reduce that number?

Mr. ANSTROM. Well, I think you have two problems there. First of all, that suggests a market-by-market test, where in effect we are competing against people—namely, DBS and the regional phone companies—who operate on regional and national bases. And the first race here is the race for capital. And I think as the investment banks and others look for financing, they are not going to pick one market at a time, they are going to look at the industry's ability to raise capital. That is the first test.

The second is that as soon as you begin applying specific percentages of how many people actually subscribe, you actually create a very perverse incentive, which is that the cable system that does very well—has a competitive price, provides great service, has a lot of programming—remains regulated because people do not buy the competitor; whereas, the company that does not do very well, and therefore a lot of people subscribe to the alternative, they are the ones who get the flexibility to price and package their programming.

Senator SNOWE. Well, I guess it is a matter to be seen. I understand the position of the cable industry. I am also concerned about what might happen to the rates of rural subscribers. And it is my greatest fear that what is going to happen is we do deregulate and we are going to see these rates go right back up again.

Mr. ANSTROM. We understand that. Again, without being repetitive here, I think that fundamentally there are choices that people have, and will have, that are going to constrain prices.

Senator SNOWE. It is when those choices come on line, that is the issue.

Mr. ANSTROM. Well, one is there today, in terms of direct broadcast satellite.

Senator SNOWE. Yes, but that is still an expensive option for most people, frankly. A lot of people in my district and my State could not afford to spend $700. So I am just wondering. I do not disagree with what you are saying and what we need to do. I am wondering when that is going to happen. And that is my apprehension, and that is what also we have to try to resolve. But the point is that when is that going to happen in terms of effective competition so that people do have a choice in terms of providers, and of course hopefully in terms of quality of service and price? I think that is the major problem.

The CHAIRMAN. Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman. I think Senator Snowe is on a good line of questioning, and I would address this to Mr. Anstrom and also Mr. Stillman. I heard a lot during the health care debate about how prices were going to come down because competition was going to be out there in the free market, and some of that is in fact happening.

Whether the quality is any good or not is a matter of another discussion. But the point is, they always said do not do anything to us in Government because we will take care of it ourselves.

Now, cable is sending mixed messages, I think, and I would like to have both of you try to give your interpretations to help me understand this. You say, Mr. Anstrom, when Senator Snowe talks about cable prices in rural areas going up, that you are very sensitive on this issue, which is a classic "what you ought to be saying" statement. It does not mean it is true. DBS, if any such service were available in some parts of West Virginia, would cost about $1000 if a person took some of the options. And that would represent 5 percent of the entire income of the average West Virginia family of four, except that in rural areas it is likely not to be as high as $20,000, so it is probably closer to maybe 10 percent of their entire income. So hence, would they make that choice; hence, is that really competition?

But I get different messages. Cable people come in and they say, now, we are going to get into phones. And 97 percent of American homes can be served by cable, we are doing digital compression, we are doing all kinds of things, and we are going to be ready to go into homes with phone service.

That implies a lot of capacity, a lot of confidence. Then cable comes in and they say oh, we are the most highly leveraged industry of any telecommunications industry, and in fact one RBOC is bigger than all of us put together. So how can you call us big? So we are highly leveraged, one RBOC is higher than all of us, more than all of us, and yet on the other hand we are ready to go into the phone service, and oh, by the way, do not worry about prices going up because we would not do that because competition would force us to do that down, or as you say, DBS, or anybody who would fool with that, is going to put themselves out of business.

I am suggesting, along with Senator Snowe, that that may not be the case in points of the country that we represent. I would just like to get both of your views on this statement that in fact, like health care when the Government was fiddling around with it in the Truman era and the Nixon era, that prices went down for a couple of years and the Government got bored and moved away, and prices went way, way up. And the Republican draft here just deregulates everything, including second tier and small cable companies and all the rest of it. What is the guarantee that DBS being the only live competitor that you put out there—I am suggesting now would be highly unaffordable to many of our people; therefore, there would not be competition—why would there not just be a substantial amount of price raising to allow you to do what you have to do because you are so highly leveraged?

Mr. ANSTROM. Let me start to answer that question this way, Senator Rockefeller, which is to compare, I think, the two options in front of this committee. And the question you raise about will prices increase?—which is what I really hear you asking here, if there was deregulation——

Senator ROCKEFELLER. That is what I am really asking.

Mr. ANSTROM [continuing]. The fact of the matter is that prices are going to increase in many cable systems whether you deregulate us or not. Prices are increasing under regulation. And the reason that is the case is because we are a business whose costs increase every year. And as you, I think very appropriately, point out, our costs are particularly going to increase because of the investments we hope to make to compete with the phone companies.

Senator ROCKEFELLER. But the price increases go through either a municipal or some other public entity before they are granted. I mean, there is some touch of the public there, right?

Mr. ANSTROM. Precisely. And I think therefore if the goal here is reasonable cable prices, is that best achieved by having 250 people at the FCC and 33,000 municipalities micromanaging the business? Or is this newly competitive marketplace which people have legitimate concerns about in terms of, will it constrain prices? Will that yield a reasonable price for cable service? And I think that is the first question.

The second question, though, is that if you conclude that you want to keep price regulation on cable, then the next question is are you confident that cable can indeed, given its leveraged position, raise the tens of billions of dollars necessary to compete with the giant phone monopolies? And I say that that way for this reason: If you look at the entire structure, the competitive theory of the broad legislation in front of this committee, the theory is that you are going to allow the Regional Bell companies to move into manufacturing, information services, burglar alarm services, information services, cable, other areas, and that their potential for anticompetitive behavior is going to be checked because they are going to have competition. And then you look around, and who is going to provide that competition?

And I would submit to this committee it is us. We are the other wire, and if we do not have the financial and investment environment to make those investments, those tens of billions of dollars, then the net result is that this committee and this Congress will have opened up a Pandora's box in terms of extending the regional phone companies' monopolies, and you will never close it again. And that is really the broad issue at stake here.

So will cable prices go up under deregulation? Sure, but they are going to go up under regulation as well, and the question is, what is the broader issue at stake here?

Senator ROCKEFELLER. No, that is not the entire question. I mean, the question is also proportionality, the difference between a completely deregulated environment and an environment which is regulated in which prices are going up in any event, and even to the extent that they allow you to say we are going straight into the phone business and have the wherewithal to do that.

Mr. ANSTROM. Well, and again, I think that what I would argue is that we think that the presence of DBS and the imminent entry of the phone companies is going to constrain the prices increases that we take in a deregulated environment. And again, I would come back to the point I think I made earlier with Senator Hollings, which is that if I am a cable company and I want to compete for the long term with that local phone company, if that is where I am headed, the last thing I am going to do, assuming I am rational at all, is poison the environment in my local community by taking price increases that my customers judge to be unreasonable. I mean, I have just committed economic suicide if I do that.

Senator ROCKEFELLER. Well, you have not where we have our farm in West Virginia because the local phone company out there is something that you have never heard of, and it covers about three counties. So I do not see them as a big threat.

Mr. ANSTROM. Well, they may also be into the cable business, however, tomorrow. And again, I think, as Mr. Neel has indicated here, there is no reason that they would not be in the cable business. Many rural telephone companies are entering, and they certainly have adequate capital, much of it financed in terms of being in business for more than 100 years.

Senator ROCKEFELLER. We just went off circular dialing a couple of years ago. [Laughter.]

Mr. ANSTROM. I think I notice that I am on thin ground here, Senator Rockefeller, that I am not going to pursue in terms of the specific area you talk about. I just think that if you look at this overall environment here in terms of the presence of DBS, and again, I think everything you know about direct broadcast satellite and what we know about the cost of cellular phones and about the cost of a VCR, but that dish price is coming down. It is going to come down from $700 to $400 next year. And in rural areas, the REA's are going to finance the cost of that dish for rural customers. They announced that last week.

Senator ROCKEFELLER. If I could just have a chance for Mr. Stillman to answer and give his view of that, I want to say as a predicate to both of you that I want to see competition and a majestic array of services available for people out there. I want to see this happen. I just do not want 10 percent of the incomes of some of my rural folks going to see that happen.

Mr. Stillman?

Mr. STILLMAN. Senator, Decker's answer really makes clear that the industry simply cannot sit here and say cable rates are not going to skyrocket again. That is the fundamental problem. Nobody is saying that they should not get a reasonable increase to reflect increases in cost or increases in franchise fees or any other sort of reasonable factor like that. The question really is how much are they going to increase? Are they going to skyrocket or are they going to climb at three times inflation until the competition is actually there in the market with an alternative for consumers, or is there going to be a reasonable cost-based increase?

Under the 1992 Cable Act, it is a guarantee that the increases will be reasonable and cost-based. If they add new programming to a regulated tier they are going to get more money for that regulated tier, and that is as it should be. What they should not be allowed to do is simply jack up their rates while they maintain their local monopoly, and not give consumers anything new in the bargain. They also said that they would not raise rates because of their concerns over their long-term health and the relationships with people so they could provide telephone service. Well, at the same time they are in here asking this committee to allow them to sell out to the cable companies, so in other words to eliminate the most likely facilities-based competition. It just does not make a whole lot of sense.

I would also point out that the cable industry seems to be able to raise a good deal of revenue under the Cable Act. They have just spent $2.1 billion on PCS licenses. They were the highest bidder in the PCS auction, so that they could try and get into that business. They have spent over $15 billion just since June 1994 buying each other up, acquiring cable systems. There does not seem to be a real problem with raising funds.

Last, Decker has raised this so-called independent study a number of times. I have a letter here that I will be glad to make available for the record which makes it pretty clear that the folks who were organizing this study were only going to pay the institutions that were doing the research if they came out with the appropriate result, if they came out with a finding that the financial community's view of the Cable Act was that it had a negative effect on the industry. I will make this available for the record.

[The information referred can be referenced in Committee's files.]

Senator ROCKEFELLER. Can I see that?

Mr. STILLMAN. Certainly.

Senator ROCKEFELLER. Mr. Chairman, I have a statement I would like to enter into the record.

[The prepared statement of Senator Rockefeller follows:]

STATEMENT OF SENATOR ROCKEFELLER

Mr. Chairman, to make an obvious point, this is an important hearing. I know you are anxious to complete this Committee's work on legislation to reshape the nation's telecommunications policy. We are surrounded, on a daily basis, by the rapid, even stunning changes in communications and the convergence of formerly distinct technologies. We need to respond with legislation that fits the demands of the modern world, and yet we also need to make informed decisions that are in the interest of both the public and our vast telecomm industry.

I commend Chairman Pressler, Senator Hollings, and other members of this Committee for their continued hard work to craft bipartisan legislation.

One specific point I want to make is my belief that we must not lose sight of our goals of protecting and advancing Universal Service, while designing measures to allow competition to develop for all communications services. I say that because both are essential to the economic growth and well being of the citizens of my own state, West Virginia, and the entire nation.

This is one more hearing that gives us the chance to reevaluate regulations put in place over sixty years ago. These rules have an enormous impact—they govern the market place of our broadcast industry, and have immense implications for American business opportunities at home and abroad. There is no question that now is the time to seriously evaluate the effectiveness of these rules and revise those that no longer reflect the realities of the marketplace.

When markets become competitive and consumers are assured a choice, we need to deregulate and revise government oversight.

I look forward to this morning's discussion on how, through reforming our telecommunications laws, we can promote a more competitive marketplace that will provide consumers with greater choice, better service and the fulfillment of the promise of new technologies.

Again, we should not let partisan politics and inactivity threaten the reputation enjoyed by our country as the world leader in research, development and deployment of information technology. We must act on the opportunity we have at this moment for comprehensive reform of a sixty year old system of rules and regulations.

Mr. Chairman, I am eager to continue to work with you and my colleagues to put forth effective, bipartisan legislation that will guide our telecommunications industry into the next century.

The CHAIRMAN. Thank you. This concludes this panel. If the room would stay in order, I want to thank the witnesses very much, and we are going to very quickly bring the next broadcast panel forward. I want to thank everyone for waiting, and I want to thank the Senators for their excellent questions.

We will now hear from Mr. Bertram Ellis, President and CEO of Ellis Communications; Mr. Edward O. Fritts, President and CEO of the National Association of Broadcasters; Mr. Preston Padden, President, Network Distribution, Fox Broadcasting Company; and Mr. Jim Waterbury, Chairman of NBC Affiliates Association.

And there will be order in the room here.

We will start with Mr. Bertram Ellis, and we will ask each member to summarize their statement to 5 minutes, and we will place the entire statement in the record, and we thank you very much, and that will allow additional time for Senators questions.

STATEMENT OF U. BERTRAM ELLIS, JR., PRESIDENT AND CEO, ELLIS COMMUNICATIONS, INC.

Mr. ELLIS. Good morning. Thank you, Mr. Chairman.

Thank you for inviting me to testify before the committee today. I am the founder and CEO of Ellis Communications, which currently owns six broadcast television stations, two radio stations, and the sports programming company Raycom. I am here on behalf of a coalition of 16 entrepreneurial broadcast groups which own a diverse group of broadcast stations located in markets throughout the country. I have three points to make this morning on behalf of this coalition.

First, the FCC's local ownership rule, the duopoly rule: This rule bars the ownership of more than one television station per market by any company. This rule is no longer good public policy. This rule was put in place at the advent of television when limited media outlets threatened competition and diversity. This scenario is no longer valid.

Second, as you write the legislation that will relax the regulations that affect the other segments of the communications industry, many of which were discussed in the previous panel, in order to promote competition, competition that will further develop the world's greatest television system, we implore you to not ignore the local broadcaster and leave the local broadcaster frozen with the regulatory policy that was written and implemented before I was even born. Congress needs to set a legislative agenda to permit the local broadcaster to own more than one television station in a market in order to compete as a multichannel provider in a multichannel marketplace.

Third, relaxation of the local ownership rules does serve the public interest. The local television station has a unique opportunity to provide local news and public service programming. But this programming is very expensive to produce, extremely expensive for a new television station, in many cases prohibitively expensive. Relaxation of the local ownership rule will permit broadcasters to enter into unique arrangements that will permit new stations to get on the air or financially disadvantaged stations to provide news, public service, and other local programming that they could otherwise not afford to do. This will enhance competition and benefit the community.

Let me amplify on these points. The video marketplace that exists now is entirely different from the marketplace that existed when the local ownership rules were last examined, again as was discussed quite at length before. We have had a significant increase in the number of television stations since this rule was last examined. But now we have 150 channel cable systems. We have MMDS systems, we have wireless systems, we have direct broadcast by satellite systems, and soon, probably, we are going to have video dial-tone delivery to every household in the country by none other than the phone company.

Each of these alternative sources of programming is a competitor with the local broadcast station for audience, and more importantly, is an increasingly strong competitor for advertising revenues. Advertising revenues are the life blood of local broadcast television. That is our only source of revenue. And in the foreseeable future I see that not changing at all. Local advertising revenues are the only source of revenue we have to fund our investment in local news and public service programming, the only thing that will differentiate us from the majestic array of services that will be provided in the future. And this income stream—again, our only income stream—is subject to increased fragmentation by very powerful multichannel providers in the world of tomorrow. Already, the cable operators in our markets have created market-wide interconnects to permit them to offer system-wide advertising across the many MSO's that might serve a marketplace.

And now the trend is toward clustering, a scenario which will permit one MSO, one cable operator, to own and control all the cable subscribers in a marketplace. At that point they will have the efficiencies in that marketplace to compete head-on for all of the advertising revenues which, again, serve as the only source of revenue to fund local programming investment by the local broadcaster. This trend will continue, and it will jeopardize the ability of the local broadcaster to invest in local news and public service programming and to invest in the technology that will permit us to be competitive in the world of tomorrow.

But I am not here to sing the blues about broadcast television. Broadcast television is a good business, and can continue to be a good business. We are not asking for special considerations, a leg up on the competition, or to turn back the clock. We want to thrive and survive in a competitive multichannel marketplace so we can invest in local news and public service programming. To that end we are searching for innovative solutions to marketplace changes.

One such solution that already exists is the local marketing agreement, a term that I hope you are familiar with, but an LMA, as it is abbreviated, is basically a joint venture between broadcasters within a marketplace to permit them to generate economies of scale through some type of joint operation. Those economies can then be used to invest in local news and public service programming. There are perhaps 50 LMA's in existence in the country right now. My company participates in one, and we compete against two, soon to be three, of these LMA's in our marketplaces. The vast majority of these LMA's have permitted a new station to actually get funded and get on the air or a financially disadvantaged station to offer programming that it otherwise could not afford to do. As a result, there have been greater options for viewers, advertisers, and programmers, and improvements in the quality and the quantity of local programming and local news programming.

In summary, we are asking that you establish in the telecom legislation an explicit policy to permit the ownership of more than one television station in the market so that local broadcasters can be multichannel providers in a multichannel marketplace. Furthermore, we ask that you direct the FCC to permit the continuation of the LMA's and/or a conversion of the existing LMA's into ownership. All in all, this will encourage innovation and result in more voices, more diversity, and more competition in the marketplace.

Mr. Chairman, at the dawn of the digital age, we urge you to change the policy that was written and implemented in the era of black and white TV. Thank you.

[The prepared statement of Mr. Ellis follows:]

Testimony

of

U. Bertram Ellis, Jr.
CEO, Ellis Communications

Before the
Committee on Commerce,
Science and Transportation Committee
United States Senate

March 21, 1995

U. BERTRAM ELLIS, JR.
SUMMARY OF TESTIMONY

- Mr Ellis founder and Chief Executive Officer of Ellis Communications testifies on behalf of a group of six television broadcast companies The group asks that Congress as part of its telecommunications reform legislation give specific policy direction to ensure that the Federal Communication Commission (FCC)'s local ownership or duopoly rule which prohibits ownership of more than one television station in a single market is relaxed

- The current version of the television local ownership rule was adopted by the FCC in 1964 at a time when scarcity of media outlets limited competition and programming diversity Since that time there has been a substantial increase in the number of broadcast television stations and in other video technology and outlets including cable and DBS and video cassette rentals At the same time local television is subject to increasing competition for advertising dollars For example cable operators through forming market-wide "interconnects" and "clustering" of local cable systems are now powerful competitors for advertising

- Advertising is the sole source of revenue for local broadcasters in contrast to their competitors The duopoly rule of the FCC prevents the television industry from making the operational and economic adjustments that are needed to thrive in the new media marketplace Local marketing arrangements (LMAs) a type of joint venture that generally involves the sale by one station of blocks of time to another station that supplies programming and sells advertising to fill that time are particularly beneficial These arrangements have enabled distressed stations to remain on the air and new stations to be built

- Congress should establish a legislative policy to permit ownership of more than one television station in a market with the goal of strengthening the ability of broadcasters to survive and compete in today's marketplace Congress should also direct the FCC to permit the continuation and conversion to ownership of existing LMA's

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Mr Chairman and Members of the Committee thank you for inviting me here today to testify on telecommunications reform legislation The policy you set in this legislation will determine the future of locally-based television broadcasting in this country

I am the founder and chief executive officer of Ellis Communications -- a company comprised of six television broadcast stations two radio stations a sports program production company and a multimedia software company I am pleased to be here as the spokesperson for a group of 16 television broadcast companies a list of which is attached to my testimony These companies own local stations that are affiliated with each of the national commercial networks as well as some stations that are independent of any network The stations are in large markets and small and in many of those in between

The issue that unites our group of diverse broadcasters is the need to change the FCC's outmoded local ownership rule the duopoly rule which says that no one can own or control more than one television broadcast station in a market Relaxation of this rule is essential if broadcast stations are to continue to provide diverse local programming to consumers including news and weather and compete with the other

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players on the information superhighway Congress needs to provide explicit policy direction in this legislation to ensure that this anachronistic local ownership rule does not impede the ability of local television stations to meet the challenges of today's marketplace

Today's local television broadcaster is a single channel outlet in a multichannel world The local video marketplace is characterized by an abundance of video channels which are becoming available due to new technologies changing economics updated regulations and soon legislation This legislation must come to grips with the hard fact of broadcasters single channel limitation Unless we too are unleashed from the restrictive rules that were developed for yesterday's marketplace America's free over-the-air locally-based television system will not be able to sustain itself and survive and continue to perform its important role

The Changing Media Marketplace

One of the most critical functions of over-the-air broadcast television over the past four decades has been to provide local communities with locally relevant programming The desire for localism is derived from fundamental societal values including the need for an educated citizenry able to take part in local decision-making I strongly believe that these interests remain fundamental and that despite the rapid introduction of new technologies providing new video programming local television stations are unique in their ability to serve their communities with local programming

However, changes in the marketplace make it questionable whether our industry can continue to serve its public as well as in past years. Both technological changes and the economics of the multichannel business make the local media marketplace a very different place than thirty years ago when two or three television stations were the only providers of video programming.

Today's media market is an increasingly expansive one. The first thing to note is that every local station now has far greater competition from other local stations than it did ten years ago. The number of commercial television stations has risen from 677 in 1970, to 883 in 1985, to over 1,160 today. That's an increase of nearly one-third in just the last decade.

This substantial increase in competition and diversity has come at a time when new technologies are providing consumers with a plethora of information sources. There are 150 channel cable TV systems, 150 channel DBS systems, 300 or 600 channel fiber based telephone video dialtone networks, and digitized MMDS and LMDS systems with an equal number of channels. These technologies, moreover, are interactive and offer opportunities for advertising, marketing, and programming, literally at a personal level to each family, and to each viewer in a local market.

And this is just video transmission media. I am not even counting other sources of video, like the local video store, or other media, like local radio, newspapers, magazines, direct mail, etc., which vigorously compete with each other and with broadcasters for the attention of the public and for the advertising dollar.

Changes in Economics

However, local broadcast stations now face formidable, life-threatening challenges from a variety of competitors for the local ad dollar. And unlike their competitors, advertising remains broadcasters' only source of revenue.

The economics of the multichannel video business, particularly the cable business, is undergoing a fundamental change, one that virtually guarantees that cable will garner an increasing share of local advertising revenues. For years, cable's share of local ad revenues has lagged behind its rapidly increasing penetration and viewership because of the fragmentation of ownership in local markets.

Increasingly, however, cable operators have been creating market-wide "interconnects," capable of offering local spots on all or nearly all of the cable systems in a market. At the same time, driven by the additional incentive to compete with the phone companies and provide a seamless local telephone service, cable operators have been "clustering" at a rapid pace, buying or trading cable systems so that they dominate local markets As a result of its recent acquisitions of Cablevision Industries Houston Industries and Newhouse for example Time-Warner now has over 30 "clusters" in excess of 100 000 homes

In Memphis where Ellis Communications owns a station Time-Warner controls 60% percent of the cable homes in the market and 34% of total homes in the market In Reno where my company also runs a station TCI controls 77% of cable and 52% of total homes Both have been aggressively acquiring cable systems in order to create super clusters

Driven by interconnects and clustering cable's share of local advertising revenues is rising rapidly hitting $600 million in 1993 an increase of 80% from 1990 and is projected to rise at a comparable rate for the foreseeable future And with the pressure of competition from the phone companies satellites and wireless cable and regulation of subscriber rates cable MSOs can be expected to accelerate both clustering and their efforts to target local advertising as a primary source of future revenue growth

Because of the increased competition from other stations and the new media many broadcast television stations particularly in smaller markets are now marginal operations The FCC has found that in 1991 smaller market stations lost on average $880 000 each Cable will not have to grab much more of the advertising market to put many more stations in the red.

We are not blind to the fact that, with your help, digital compression may give broadcasters an additional path into the multichannel video business. But the digital conversion will require a formidable capital investment. For many stations, particularly in smaller markets, the feasibility of that investment is at best highly questionable. To make it possible we need two things: we need to be able to get into the business of providing more than one programming service today and we need to be able to take advantage of economies of scale. Hamstringing us with the current ownership restrictions could mean that many broadcasters will never make it to the digital world.

Fostering Broadcasters' Ability to Compete in the New Video Marketplace

While we've seen enormous changes in the technology and economics of video business -- changes that have outmoded the entire structure of broadcast ownership regulations -- the most substantial changes lie immediately ahead. Before the Congress further unleashes the telephone and cable industries to compete for audiences and our advertisers, provisions must be made to overhaul the broadcast regulatory structure to enable television broadcasters to compete on the information highway. Legislation is needed. Acting within the confines of the 1934 Communications Act, the FCC is not likely to make the fundamental changes that are needed without clear policy direction from Congress -- and make no mistake about it fundamental changes are necessary

The need for legislative direction is clear today. The FCC has recently issued a Further Notice of Proposed Rule Making seeking review of the duopoly local ownership rule, as well as other regulatory requirements affecting the television industry. This Further Notice amply illustrates the need for new policy direction from Congress. The Further Notice extends a regulatory review begun in 1991, after a significant internal report at the FCC observed the many changes that even then had affected the television industry. During the intervening four years, marketplace change has accelerated, the ownership rules have become increasingly anachronistic, but there has been no FCC liberalization in this area for television. The FCC's newest examination of competitive realities threatens to produce -- at best -- changes that are too late and too modest.

At present, despite the fact that broadcasters' principal competitors (cable) are free to consolidate their ownership of facilities in a local market, the FCC's duopoly rules absolutely bar television broadcasters from owning more than one television channel in a market. The prohibition applies across the board -- without regard to the competitive and other conditions in each local broadcaster market and without regard to the level of consolidation among and competition from non-broadcast video competitors. This leaves broadcasters in the untenable position of being forced to compete against multichannel competitors with only one channel per market.

To respond to the challenges of today's media/advertising marketplace, a significant number of television broadcasters, emulating their colleagues in radio broadcasting, have entered into innovative arrangements called local marketing agreements (LMAs). An LMA is a type of joint venture that generally involves the sale by a licensee of blocks of time on its station to another station -- in the same or adjacent market -- which then supplies the programming to fill that time and sells the advertising to support it. Such agreements enable separately owned stations to function cooperatively, achieving significant economies of scale via combined sales and advertising efforts, shared technical facilities, and joint programming arrangements and increasing stations' access to diverse programming.

No one knows precisely how many LMAs there are. We believe there may be as many as 50, with several others in the works. In the vast majority of these cases, the LMAs have enabled financially distressed stations, usually UHF stations, to stay on the air, or have made it possible to build new stations which otherwise would not have gone on the air.

LMAs have played an important role in preserving opportunities for local broadcasters to contribute to their communities. For example, Kentuckiana Broadcasting held the construction permit for Channel 58 in Salem, Indiana, not far from Louisville, Kentucky, but was unable to get bank financing to build the station. Through an LMA with WDRB, the Fox affiliate and Channel 41 in Louisville, Kentuckiana got its financing and now provides another well-programmed choice for viewers in that market.

In other instances, LMAs have saved failing stations. Take WOTV, the ABC affiliate in the Battle Creek-Grand Rapids-Kalamazoo, Michigan market. From 1985 to 1990, squeezed by competition from an overlapping ABC affiliate, the entrance of new stations in its market and increased programming costs, this locally owned station lost over a million dollars a year. Finally, in 1990 the station discontinued carrying any local newscasts. Even eliminating these costs, however, did not save the station and it faced the prospect of going dark. But at the last moment, in late 1991, the stations entered into an LMA with WOOD, the NBC affiliate in Grand Rapids. As a result of the operating efficiencies of the LMA, Channel 41 is once again profitable and, more important to the local community, is once again producing 6 p.m. and 11 p.m. newscasts, as well as sponsoring a wide variety of civic activities and promotions in Battle Creek and Kalamazoo.

In the case of my own company, the LMA we have in Fort Meyers has permitted us to do a much better job on news than we otherwise would have been able to do.

These cases are the norm, not the exception. In virtually every instance, LMAs have resulted not only in increased competition in the local video market with greater options for viewers, advertisers and programmers, but substantial improvements in the quality and quantity of local news and other local programming.

The experience with LMAs in radio and television and the benefits that limited relief from the duopoly rules have brought radio broadcasting are good indications that duopoly relief in television will produce a healthier industry, and lead to more free over-the-air programming and advertising choices for consumers in the local market.

Recommendations

For the reasons I have discussed, we recommend that Congress act to ensure the ability of broadcasters to compete in a fair and equal fashion in the emerging multichannel marketplace. If you leave the local station frozen in regulation from 50 years ago, crafted for a different marketplace, we will not be able to compete in the multichannel, video marketplace of the 90's. Congress must do more in the telecommunications legislation than leave this important issue to the FCC. It must provide a policy framework in the legislation that will allow broadcast television stations to survive and compete in the marketplace.

We think the telecommunications legislation should establish a legislative policy to permit ownership of more than one station in a market with the goal of strengthening the ability of broadcasters to survive and compete in today's multichannel marketplace. The FCC should also be directed to permit the continuation and conversion to ownership of existing LMAs. These policies will result in more diversity and competition.

In order for broadcasters to continue their important role as providers of diversity and competition in the local market, steps must be taken to remove rules that render broadcasters too weak and cash strapped to produce their own quality local programming and obtain other attractive programming for their viewers.

We are not asking for subsidies; we are not asking for a "leg up" on the competition. We are asking for explicit policy direction in the telecommunications legislation of 1995 to ensure relaxation of the outmoded FCC local ownership rule to give local television stations the flexibility to continue to be viable, active providers of free over-the-air programming to consumers.

Broadcast Coalition:
Support for Relaxation of T.V. Local Ownership Rule and Continuation of LMAs

ABRY Communications
Boston, MA

Act III Broadcasting, Inc.
New York, NY

Argyle Television Holdings, Inc.
San Antonio, TX

Blade Communications, Inc.
Toledo, OH

Clear Channel Television
Franklin, TN

Ellis Communications
Atlanta, GA

Granite
Morganton, NC

Kelly Broadcasting Co.
Sacramento, CA

LIN Television Corporation
Providence, RI

Malrite Communications Group, Inc.
Cleveland, OH

Outlet Communications, Inc.
Cranston, RI

Pappas Telecasting Companies
Visalia, CA

Providence Journal Broadcasting Corporation
Providence, RI

River City License Partnership
St. Louis, MO

Sinclair Broadcast Group, Inc.
Baltimore, MD

Waterman Broadcasting Corp.
Fort Myers, FL

The CHAIRMAN. We shall next hear from Mr. Edward O. Fritts, President and CEO, National Association of Broadcasters.

STATEMENT OF EDWARD O. FRITTS, PRESIDENT AND CEO, NATIONAL ASSOCIATION OF BROADCASTERS

Mr. FRITTS. Thank you, Mr. Chairman. Let me first congratulate you and Senator Hollings and your colleagues on both sides of the aisle for attempting to move forward on telecom legislation, and more specifically to include broadcast provisions in this. We know that you and your staffs have worked very hard thus far to bring forward legislation, and we appreciate the outstanding job already done, and look forward to participating as we go through this process.

John F. Kennedy once said, and it reminded me of listening to the first panel which appeared here earlier today, what is mine is mine and what is yours is negotiable. And I think that is what all this is about. It is about competition, it is about new entrance into the video marketplace, it is about competitors who want, quite frankly, to topple the broadcast industry and to get a piece of the action. Frankly, the only way that broadcasters, who are the only ones tasked with providing free over-the-air service to the citizens of your communities, can survive is that we are included in a regulatory framework, and we have confidence that the regulation that you craft will do that.

As you know, NAB as an institution is neutral on the television ownership issues. However, I have three of my colleagues here today who can clearly and definitively put forth the positions of the various facets of our great industry. But I do want to talk about radio ownership issues, because there we do have unanimity in the industry. The radio rules that we look at today at the FCC are clearly obsolete and need to be changed. There is an over-saturation of the FCC population of radio stations. If you think about it, we are in an era of 11,000 commercial radio stations, so that virtually every village, every hamlet, and every city has a multiplicity of voices serving the local community. We think that is important, but we also think it is important that those stations are viable so that they can serve those communities well.

The FCC is proposing and getting ready to approve satellite digital audio services which would in essence dump 60 new radio stations into virtually every market, large or small, throughout the United States, these likely to be owned by one entity or one individual. Currently, the cable industry provides an additional 30 audio services into virtually every market in the United States, and I might add that none of these, either cable nor the satellite digital radio, have any public interest obligations nor do they have any responsibility to serve the local communities across this country, but can become clearly audience competitors against the local radio.

The only way we can compete in radio, we believe, is through consolidation at the national and at the local level. Even if one individual owned 100 radio stations across the country, they would still have but 1 percent of the total marketplace. Now, the FCC made some effort at removing and relaxing those rules in 1992, and that history might be somewhat instructive. The radio industry today is stronger, values are higher, the number of stations which were going off the air because of financial hardship have declined, and a reverse trend has begun.

We also support what we call some license reforms that I know that your committee is considering. A two-step license renewal process at the FCC, we believe, is key. Let us just think for a minute that if a licensee has served the public interest well, it has not seriously violated FCC rules, then we believe it ought to be judged first, before allowing competing applications at renewal time. As a matter of fact, the FCC, indeed, itself has suggested this as a part of their reinventing government. This would not preclude petitions to deny for the bad apples. The broadcasters clearly must continue to serve the public interest.

Let me turn briefly now to what we think is the issue of the day, and that is digital television. It is an exciting new technology, and it will enhance the current system of broadcasting as we know it. Unfortunately, through erroneous reporting oftentimes instigated by our would-be competitors, this issue is somewhat misunderstood. The issue is competition while protecting consumers. Can broadcasters compete against the plethora of new services that you have heard today which are coming? How do we and you preserve free over-the-air universal television and radio for your consumers?

Spectrum flexibility, as proposed in this legislation, would allow broadcasters to compete as we move to digital broadcasting. Some people—and let me confront this head-on—have called this a spectrum grab by the broadcasters, and let me debunk that myth early and often. The facts are there are 230 million television receivers in the marketplace today. Could we start broadcasting within 3 years digital television? We probably could, but you would require every one of your constituents and our consumers to buy a new converter box at about $150 to convert to that. So you have chosen a rational approach through the FCC, or the FCC has, whereby broadcasters could transition to 6 MHz over a 15-or 18-year period and be able to have an orderly transition in the marketplace to digital television which can be high definition television. It can also, with spectrum flexibility and compression, allow broadcasters to provide many additional services, most of which would be free to your consumers they are now paying for elsewhere. You have said you want a bill that is technology neutral. I would suggest that unless spectrum flexibility is included in this bill, it will not be technology neutral.

And the final point, as we have heard the 800-pound gorilla and the 750-pound gorilla here this morning, the final point is that we support moving legislation, but we have to have fair access for all users onto the cable and onto the telephone networks. We have to have navigation devices on the clicker that are fair and nondiscriminatory, because remember, who owns the wire also controls the navigation devices. And they should, in fact, operate through separate subsidiaries.

In closing with the caveat that we do not take a position, again, on television ownership, NAB strongly supports radio deregulation, license reform for radio and television, spectrum flexibility to allow us to compete, safeguards to ensure access and fairness in the marketplace. Again, let me offer on behalf of our industry our commendations to all of you for considering this legislation. We look forward to working with you as it wends its way through the process. Thank you very much.

[The prepared statement of Mr. Fritts follows:]

National Association of
NAB
BROADCASTERS

Testimony of

Edward O. Fritts

Before the
Senate Committee on
Commerce, Science & Transportation

March 21, 1995

I am Edward O. Fritts, President and CEO of the National Association of Broadcasters. I appreciate the opportunity to testify today about telecommunications legislation. NAB represents almost 1,000 television stations and more than 4,300 radio stations, as well as the major broadcasting networks.

NAB strongly supports the enactment of telecommunications reform legislation this year. Mr. Chairman, the new technologies and new players that are entering every communications market have finally outrun even the flexible provisions of the 1934 Communications Act. The communications marketplace is now beset with uncertainties, with policies often being set more by litigation than by policymakers in the Congress or the FCC.

Your bill is based on the view that the time is now past when communications companies can be "pigeon-holed" into distinctly different niches. Instead, it recognizes that technology no longer requires, nor even permits, traditional distinctions between providers of different types of telephone service, cable companies, and broadcasters. It looks to a new regime where the activities of communications companies are determined by their own entrepreneurial energies and success in the marketplace, and not by decisions made here in Washington.

Broadcasters support the overall thrust of the bill and stand ready to move into the new communications marketplace. They, like other communications suppliers, need to be freed from regulations that inhibit their abilities to offer new and competitive services. Broadcasters, however, also see a need for regulation to ensure that their traditional role as the supplier of universal, free services is maintained, and that anticompetitive actions of other companies cannot put them

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into a situation where they cannot compete. Let me turn to some of the specific areas in which reform of broadcasting regulations has been suggested.

Ownership Rules

As you are aware, while the television industry is agreed on most issues relating to this legislation, there are differing views on the question of changes in the FCC's television multiple ownership rules, both with respect to the national "caps" and the rules governing ownership of stations in local markets. Today, you will hear testimony from television broadcasters who represent the range of opinions on the ownership questions. On this issue, however, NAB is neutral.

On the separate question of changing the ownership rules for radio, NAB strongly supports the approach taken in the discussion draft of eliminating all remaining restrictions on radio ownership. There are more than 11,000 radio stations operating in the United States. Under the FCC's current rules, no one entity can control more than 40 stations (20 AM and 20 FM) with the possibility of a small additional "bump-up" for minority-controlled stations. The radio market is so diverse that there is no possibility that any one entity could gain control of enough stations to be able to exert any market power over either advertisers or radio programmers.

Similarly, while the FCC several years ago modified its duopoly rules to permit limited combinations of stations in the same service in one market, there are still stringent limitations on the ability of radio operators to grow in their markets. Further, the FCC's rules permit only very restricted or no combinations in smaller markets. These limitations hamper the ability of radio broadcasters to provide the best possible service to listeners.

Increased multiple ownership opportunities would allow radio operators to obtain efficiencies from being able to purchase programming and equipment on a group basis, and from combining operations such as sales and engineering. Radio stations have had to face increasing competition from new radio stations and from other advertising and programming sources, such as cable television operators. Further, many cable operators have begun to provide music services that compete with radio stations, and the FCC is developing rules for a new satellite-delivered audio service that may deliver 60 channels of digital music in every market. In the near future, radio stations will also begin to face the need for new capital investment when the FCC authorizes terrestrial digital audio broadcasting. Without the opportunities to grow and to attract capital, the radio industry will face an increasingly difficult task in responding to these new competitive pressures.

The experience of the industry following the FCC's limited relaxation of the radio rules several years ago is instructive. Prior to the FCC's action, there was little investment capital flowing to the radio industry. After the FCC permitted greater ownership opportunities, the radio market revitalized, and became again an attractive area for investment. If the Congress acts this year to eliminate all ownership rules for radio stations, the ability of the radio industry to grow and to provide better service will simply take off.

Mr. Chairman, these are the benefits that will flow from radio ownership deregulation. I am unaware of any threats to the public interest that could arise if radio ownership decisions were made by operators and investors, and not the federal government. NAB, therefore, supports the proposals you have made to eliminate government controls over radio ownership and investment.

Spectrum Flexibility

As we move into the new communications environment you seek to foster, it is important that the providers of services that form the backbone of today's communications market be permitted to compete effectively. As repeated surveys have demonstrated, local television stations are the core of today's video market. Most Americans obtain their news and the majority of their

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entertainment programming from local television stations. These stations devote an increasing percentage of their total revenues to providing news and public affairs programming and otherwise serving the needs of their communities.

Today's television broadcasters, however, are increasingly at a technological and regulatory disadvantage. The new entrants to the video market, be they cable systems, telephone companies, or others, are able to provide multiple channels of programming, compared to the broadcaster's one. Most important, the new delivery systems that will be coming on-line in the next few years will all be digital. Digital services permit not only the transmission of vastly increased amounts of data, they also are more flexible and, for video signals, they can provide pictures of far greater quality than our present analog system. Your bill includes a provision which will permit television broadcasters to be part of this digital transformation.

As you know, the FCC, broadcasters, and the electronics industry have spent years planning for a new Advanced Television Service (ATV) that ultimately will replace the present NTSC analog system of television broadcasting. The FCC expects to receive a recommendation for such a new system later this year. When it began to consider plans for conversion of over-the-air broadcasting from analog to digital, the FCC recognized that it could not make all existing TV sets obsolete overnight. Doing so would leave every household in the United States without television service and turn 200 million sets into junk. At the same time, the FCC recognized that, if broadcasting were to remain competitive, television stations must be able to use digital technology.

Thus, the Commission concluded that there must be a transition period during which television signals will be available to consumers in both analog and digital formats. Because the laws of physics prevent analog and digital TV signals from being provided over the same channel, the

FCC adopted a plan under which each existing full-power television station will be assigned an additional 6 MHz channel on a temporary basis. Stations will provide ATV service on the new channels, while continuing to serve the public owning analog receivers on their existing channels. If ATV service proves successful in the market, and when most analog TV sets have been replaced with digital receivers, the FCC plans to end NTSC broadcasting and recover one of the two channels.

The broadcast spectrum flexibility proposal builds on this foundation laid by the FCC. For broadcast stations, the FCC's plan creates both opportunities and difficulties. Conversion to digital broadcasting will allow stations to provide better services to their viewers. At the same time, the construction and operation of what in effect is a second station will place huge capital demands on stations and, to the extent that the digital signals duplicate existing analog service, stations will realize little or no additional advertising revenue from ATV service. The spectrum flexibility proposal we support will encourage the transition to digital service by providing the opportunity to provide new and innovative services as part of an ATV signal.

In a digital television service, the amount of the total bitstream that is needed to produce a television picture and sound will vary from moment to moment, depending on what is happening on the screen. In a fast-moving basketball game where the action on the screen may shift rapidly, virtually all of the data capacity may be needed to provide the television signal. On the other hand, if a station is broadcasting a "talking head" interview, only a small portion of the total bandwidth might be needed to update the picture. Because of this feature of dynamic scalability characteristic of digital systems, the rest of the bitstream could be used to provide other services, such as supplemental program information or specialized information services.

Under the spectrum flexibility provisions we propose, the FCC would be directed to go ahead with its plans to assign ATV channels to local stations and to permit those stations to provide, as part of an ATV signal, other services that are ancillary and supplemental to their free, over-the-air television service. These services would be limited only by the technical limits of the television signal and by the requirement that stations continue to provide a free, over-the-air ATV service to viewers.

The benefits of this proposal will flow to the public and to broadcasters. If broadcasters can provide new and innovative services, the public will benefit by having access to such services. If they compete with services provided by other entities, the public will benefit from the competition in the form of lower prices and higher quality. If broadcasters can seek out additional revenue sources from digital broadcasting, that will help speed up their conversion process and defray the enormous costs of providing the new service.

Mr. Chairman, we have heard of many objections to this proposal. On examination, however, these concerns are unfounded. First, some have argued that additional spectrum should not be allocated to broadcasting. I have several responses. Most important, neither our proposal nor the FCC's established ATV plans require the allocation of *any new spectrum* to broadcasting. The spectrum from which ATV channels will come was allocated to television broadcasting fifty years ago. It has not been assigned to stations because, in most areas, analog television signals could not be provided on those channels without creating interference to other stations. Digital technology allows these frequencies to be used.

Others have questioned why these channels should be assigned to existing local stations, rather than being made available to others. The FCC carefully considered this question and concluded that initially restricting the availability of ATV channels to existing television broadcasters "is the most practical, expeditious, and non-disruptive way to bring improved service to the American public."[1] Note that the restriction is only for the initial assignment of licenses; if a particular station does not begin to provide a digital service within a reasonable period after specific licenses are assigned and digital equipment becomes available, we expect that the FCC will offer that channel to other users.

Moreover, those who argue that this is merely a spectrum "grab" by broadcasters ignore several salient points. This new spectrum that stations will be allowed to use is transitional. It will be assigned to stations only for the purpose of allowing them to change to a new delivery system. Further, it is not spectrum that can be used for any purpose. The primary purpose of the second channel will remain the same as the primary purpose of broadcasters' existing channels — providing free, over-the-air television service. Those who argue that these channels should be made available to new television stations ignore the fact that those stations could only survive by offering an analog service, a service that could not be provided on these channels without causing interference. Those who instead argue that the non-broadcasters should be allowed to compete for these channels forget that computer companies or common carriers are not likely to want to use most of the spectrum to provide a broadcast service.

Most of the objections to spectrum flexibility, however, appear to come from those who fear that ancillary and supplemental services provided by broadcasters will compete with them. They argue that television stations should be restricted to providing traditional television service and that it would be unfair for broadcasters to provide services over television spectrum that competes with services for which others had to obtain spectrum through auction. These concerns

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[1] *Advanced Television Systems (Second Report and Order)*, 7 FCC Rcd 3340, 3342-43 (1992).

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are similarly unjustified. The entire thrust of your bill, Mr. Chairman, is to promote competition and eliminate artificial distinctions between the providers of communications services by allowing anyone to provide whatever services they can that are able to succeed in the market. Providing that freedom to cable systems, telephone companies, PCS providers, and everyone else except local broadcasters would be unfair and harmful to the public interest. So long as broadcasters meet their public interest obligations and use ATV spectrum to provide whatever ATV services are directed by the FCC, there is no reason why they should be barred from providing additional services within the same spectrum.

Further, the FCC has long permitted radio and TV stations to provide additional services on subcarriers or in the television vertical blanking interval, and stations have done so without in any way lessening their main service to the public. The same principle should be followed when the FCC authorizes ATV service, where the potential for new services is so much greater.

What many of these companies appear to fear is competition, particularly competitors that may provide more attractive services. Most proposals we have seen for new services contemplate imposing usage charges on consumers. Many of the new services that this provision will allow television stations to provide may instead be advertiser-supported and free to the consumer. If consumers believe those services are better or more attractive, that should be the choice of the marketplace, rather than the result of a directive from Washington.

The argument that broadcasters will receive an unfair advantage from the spectrum flexibility proposal simply ignores the actual proposal. Where broadcasters offer services in competition with other providers who obtained their spectrum through auction, the proposal authorizes the FCC to impose a fee on the station offering those services. In setting these fees, the FCC is directed to consider how much spectrum is being used and how much time a broadcaster devotes to a particular service, and the amount that competitors paid for their spectrum. Permitting broadcasters to offer new and innovative services thus will provide them with no unfair advantages.

What particular services broadcasters may offer no one can tell. However, it is certain now that, if television stations are to move into the new world of digital communications, they must have the ability to transition their existing services to digital without "disenfranchising" the millions of households with analog reception equipment, and they must be allowed to use their ingenuity and business skill to develop new services consistent with their obligation to provide a free, over-the-air television service in the public interest. The additional channel proposed by the FCC that your bill would provide is needed to ensure that all Americans continue to receive free over-the-air television service during the period when broadcasting in changing from analog to digital to the ultimate benefit of the entire public.

Broadcast Licensing

Another issue which we have asked you to address concerns the outdated broadcast licensing provisions in the Communications Act. More than a decade ago, Congress extended the normal term of an FCC license to ten years for every type of licensee except broadcasters. Although broadcast license terms were extended to some degree, television licenses still only run for five years and radio licenses for seven. These exceptions to the rule applicable to all other FCC licenses should be eliminated. Shorter broadcast license terms impose an unneeded burden on both broadcasters who have to file applications and on the FCC which has to process them. Adopting a uniform ten-year license term would significantly reduce the FCC's processing work load. The FCC's ability to ensure that broadcast stations operate in the public interest would not be affected. The Commission would retain its full powers to consider any complaints about a broadcast station during its license term, or to initiate any investigations or proceedings it deems appropriate. Further, if a station's conduct warrants, the FCC would retain its authority to call for an early renewal application, or to grant a renewal for a shorter term than the maximum authorized.

The second area in which the licensing provisions need reform deals with the way in which the FCC handles renewal applications. Traditionally, when a renewal application is filed, the FCC allows a period during which the public can petition to deny the renewal and competing applications for the same facilities can be filed. We propose that the process be amended to require the FCC to consider the renewal application before it accepts any competing proposals.

The FCC's current process has been the subject of ceaseless criticism from the courts and from many other observers and participants. Comparative renewal cases are among the longest proceedings in administrative law. Most frequently, they focus on questions about the fitness of the applicants that are far removed from any consideration of the quality of service which either has been or will be provided to the public. Often, such applications were filed as a way of extracting a payment from the incumbent licensee in order to avoid a protracted proceeding. The Congress recognized that these "shake-downs" were occurring and amended section 311 of the Communications Act to prevent these so-called "strike" applications. Moreover, the FCC's standards for selecting among competing applicants were recently struck down by the courts, and the Commission has to date been unable to develop acceptable new criteria.[2]

The answer we believe to these problems is to do away with comparative renewal proceedings entirely. Instead, the FCC should accept renewal applications and consider them in accordance with its usual renewal standards, including allowing petitions to deny or informal objections from the public in the same way the FCC now handles non-comparative renewals. If the renewal applicant demonstrates that it has served the public interest and not engaged in a pattern of violations of the FCC's rules, its application would be granted. If the FCC finds otherwise, it could take either of the steps the law now provides — either renew the license under conditions or deny the renewal application. Only if it denies the application would it accept new applications for the channel.

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[2] *See Bechtel v. FCC*, 10 F.3d 875 (D.C. Cir. 1993).

The FCC, in its proposals for reinventing government, also suggested the elimination of comparative broadcast renewal proceedings. Indeed, for cellular telephone renewal applications, the FCC already adopted a similar two-step renewal procedure on its own.[3] It found that a two-step renewal process would encourage investment by licensees in their facilities since they would be freed from the fear of an expensive comparative challenge. The FCC also concluded that, since comparative hearings necessarily involved a distorted comparison between the actual record of the incumbent licensee and mere promises of the competing applicant, they created the risk of replacing an acceptable licensee with an inferior one. Third, the FCC determined that a two-step renewal process would avoid needless disruption in service to the public. All of these factors are equally or more applicable to broadcast renewal proceedings.

Radio and TV stations expect to be scrutinized by the FCC at renewal time. What we ask is that the renewal process focus only on the record of the licensee, and not on the arcane and expensive legal maneuverings that mostly characterize comparative renewal hearings.

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[3] *License Renewals in the Domestic Public Cellular Radio Telecommunications Service*, 8 FCC Rcd. 2834, *recon. denied*, 8 FCC Rcd. 6288 (1993).

Safeguards

Finally, I would like to discuss some areas in which we think regulations will be needed to make sure that, as new video delivery systems are established, the providers of those systems will not engage in anticompetitive actions that could destroy competition between them and other program providers, particularly local broadcasters. The experience with the cable model has shown all of us that where one company provides both transmission capacity and programming, there is a substantial risk of that company taking action to disadvantage competitors. There are other types of regulations that the FCC adopted to ensure the integrity of marketplace arrangements, such as program contracts that also need to be extended to telephone company-provided video delivery systems.

If local broadcasters are to compete in the new video environment and continue to provide diverse local service both to subscribers of cable and telco video systems and those who receive their television over-the-air, it is absolutely essential that stations have access to viewers. Local television service is now, and for the foreseeable future will be, primarily supported by advertising. If the audience cannot see a station, that station cannot sell advertising and its programming will inevitably suffer. Thus, protections for stations' access to the audience are foremost among the safeguards we believe must be included in any legislation.

Among those protections is an extension of the must carry provisions of the Cable Act to the telephone company environment. Several of the telephone companies proposing video dial-tone service have asked the FCC for authority to carry local stations to all subscribers on a "will-carry" basis, indicating they recognize the need for such protections. Although the telephone company video environment is more complex than the cable model, since there may be a number of separate program suppliers on the system, we think that a fair approach would be to place must carry obligations on the telephone company's programming affiliate, particularly if, as your discussion draft proposed, telephone companies are required to use a separate affiliate to provide video programming to subscribers. If instead you ultimately permit telephone companies to provide video programming directly, then we think the carriage obligation should fall on whatever entity is providing programming directly to subscribers. There are good arguments that carriage obligations should be extended more broadly, but we think this proposal does not unduly burden any supplier and will have broad support among broadcasters.

We also ask that you establish guidelines for menuing and navigation systems. With the possibility of 500 or more "channels" on new video delivery systems, the design of the interface between the system and consumers can make the difference between a signal that consumers watch and one they ignore. We think that you should establish several principles for the FCC to enforce in connection with navigation systems. For example, we think that consumers should be able to gain access to a local broadcast signal without having to go through several levels of menus or having to click on repeated "boxes" on a screen. Instead, the navigation systems should ensure that broadcast stations can be selected as easily on new systems as they are today, and the menus should clearly identify the source of all program choices. Second, whatever menuing system is adopted should preserve the integrity of a broadcast signal. Subscribers should be able to select a broadcast signal from a menu which identifies it as a local station, and not simply from a menu of program categories. Further, the navigation systems should maintain the integrity of program channels, so that when one program ends, subscribers' sets remain on that channel, rather than automatically returning to a menu. We also think that the FCC should have the authority to ensure that equipment, such as set-top converters, that is provided to subscribers

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cannot restrict subscribers' easy access to broadcast or other signals provided by companies other than the telephone company or other program service provider.

In addition to these navigation and access issues, a crucial protection the FCC has long enforced in the cable environment must be extended to video signals delivered over telephone company facilities. We ask that you require the FCC to extend the coverage of its network non-duplication and syndicated exclusivity rules to all providers of video signals over telephone company facilities. These regulations do not impose government restraints, instead they merely permit the enforcement of private contractual arrangement for programming. Absent these protections, distant broadcast signals carrying the same programming as a local station could be imported, even though the local station negotiated and paid for the exclusive right to carry that programming in its area. These rules are needed to preserve the integrity of established local broadcasting markets.

To reiterate, Mr. Chairman, broadcasters believe that the adoption of telecommunications legislation this year will help usher in a new area of advanced and innovative services for the public. Broadcasters look forward to competing in these new arenas, and we support your efforts to enact legislation. I will be pleased to answer any questions you may have on any of these matters.

The CHAIRMAN. Thank you very much.

Mr. Preston Padden, President Network Distribution, Fox Broadcasting Company

STATEMENT OF PRESTON R. PADDEN, PRESIDENT NETWORK DISTRIBUTION, FOX BROADCASTING COMPANY

Mr. PADDEN. Thank you, Mr. Chairman, and I would like to start by joining Eddie in thanking you and Senator Hollings and all the other members of the committee for your leadership in this bill, and most importantly for not leaving broadcasting behind as you streamline the way to the 21st century for the people that use wires to do their business.

Fox, the three other networks—I started to say older networks, but I will not say that—and many, many other local broadcasters across the country strongly favor the deregulation of broadcast station ownership. We believe that when you look at the objective facts and apply the same deregulatory philosophy that applies in the bill to other providers, you will conclude that the most appropriate course is to simply repeal those rules.

The simplest way to state it is that these ownership regulations are left over from a bygone era in our business, an era of scarcity, an era when there only three networks, and in most communities only three television stations. In those days the business was heavily regulated, highly profitable, and virtually risk-free. Believe it or not, in those days if a broadcaster wanted to block a new competitor from coming on the air, all he had to do was file a petition at the FCC with a bunch of economic statistics showing that a new station would harm the existing stations, and they could actually keep competition from coming in. Those days are long gone.

Today, we have got a wildly competitive television marketplace. We have hundreds and hundreds of new local stations. We now have six broadcast networks. Cable passes 96 percent of all TV households. There are more than 100 cable networks, and apropos the discussion you had earlier about whether DBS competition is really here yet, I can tell you cable competition is really here for the broadcasters. I have got yesterday's Daily Variety that has a headline, "Cablers Outdo Nets," and the first line of the story says for the first time basic cable networks beat the four broadcast networks in a given time period, 1 to 4:30 p.m. on the four February sweep weekends. Our competition is very real, and it is here today. And of course, as you heard earlier, DBS dishes are selling as fast as they can be made.

We think there is plenty of evidence out there in the marketplace that all of this competition is in fact a better servant of the public interest than regulation ever could be. All of this new competition has brought consumers program choices that could never have been mandated by regulation, including an increase in the amount of local news broadcast by stations since the last time the ownership regulations were relaxed. And of course, your bill is going to bring even more competition by unleashing seven of the strongest economic forces in this country to enter our business, and I am not embarrassed to say that is more than a little scary to all of us in broadcasting.

We could be sitting here today asking you for protection from those 800-pound gorillas. But we are not doing that. We get the drift of policy here, and our only request is if we are going to have wide open competition, let the same standard apply to the broadcasters. In our view it would be a tragedy to streamline the Communications Act for the people who use wires and charge people for programming while leaving the free over-the-air broadcasters locked in a regulatory straightjacket that dates back to 1927.

We think there is a lot more at stake here than just our profits and our economic viability. Believe it or not, we do not think that plain old broadcasting has to be the gray old lady of this business. We think broadcasting's best years are still ahead of it. And if freed from a lot of outdated regulation and allowed to utilize the latest technology, we think broadcasters can do a lot more than just be a programmer riding on somebody else's information superhighway. We think we can build a wireless superhighway of our own that will provide needed competition for the people using wires to bring programming to people.

Our worst fear is that you will unleash strong new competitive forces in our business, deregulate everybody else, but when it comes to us not act based on the competitive facts and the deregulatory philosophy but rather continue to regulate us based on some kind of arbitrary compromise numbers. We urge you to look hard at the competitive facts and choose the option of complete deregulation of broadcast ownership.

I would like to conclude by reading a very short letter that was sent to Senator Burns—I am sorry he is not here to hear it—by a small television broadcaster in Montana. I think it is eloquent in its brevity.

It reads: "Dear Senator Burns, as you know, the Senate is considering legislation to deregulate the ownership of television and radio stations. For reasons I cannot fathom, some people in the television industry oppose such deregulation. We are a small company with television stations in Billings and Miles City.

"I oppose ownership limits on general principle, and because their practical effect is to artificially constrain the television market limiting innovation and economics of scale. Conversely, these limitations serve no public interest. Remember that whoever owns the stations will have the same public interest desires and requirements. The people in each market do not benefit from keeping out potential owners based on artificial criteria like number of stations.

"Please support the absolute elimination of ownership limitations, or the closest you can get to it."

We would second the sentiments of the author of this letter. Thank you very much.

[The prepared statement of Mr. Padden follows:]

Testimony of

Preston R. Padden, President, Network Distribution,
Fox Broadcasting Company

before the

Senate Committee on Commerce, Science & Transportation

Tuesday, March 21, 1995

Testimony of
Preston R. Padden, President, Network Distribution,
Fox Broadcasting Company

EXECUTIVE SUMMARY

Fox strongly supports repeal of the existing restrictions on (1) the multiple ownership of broadcast stations nationally, (2) the ownership of more than one station in a single market and (3) the cross ownership of broadcast stations and other media properties. These restrictions date back to a bygone era of media scarcity.

Today, new competition from more broadcast stations, more broadcast networks, cable and satellites provide consumers with an abundant diversity of television choices. In this environment the broadcast ownership restrictions serve only to inhibit the competitive effectiveness of broadcasting relative to other communications media.

There is substantial evidence that competition is a far better servant of the public interest than is regulation. Since the last relaxation of the broadcast ownership rules, local news programming has increased. Moreover, large group owners, including the networks, are proven leaders in local news.

Because of new competition by Fox, local affiliate stations have gained significant leverage in their relations with their networks. In the last year alone, attempted "affiliate raids" by Fox have caused the three other networks to increase compensation to their affiliates by hundreds of millions of dollars. The arguments against deregulation by some affiliates suggest an anti-competitive desire to limit the growth of competing broadcasters and to limit competition for station acquisitions.

It would be a tragedy and would disserve the public interest to streamline the Communications Act for wired media like cable and telcos that charge the American people while leaving free over-the-air broadcasting in an antiquated regulatory straight jacket. If freed from regulatory constraints and permitted to utilize the latest technology, plain old broadcasting can be transformed into a service rich, wireless superhighway in its own right.

The three other networks and many local broadcasters (each in its own way and each to different extents) all support broadcast deregulation. The legislation currently being considered will unleash tremendous new competitive forces within the television industry. We have resisted the temptation to resort to protectionist pleas. Our only request is for reasonable symmetry in regulatory treatment and reasonable symmetry in opportunity. Having chosen competition with regard to other media, it would be unfair to retain strict regulation of broadcast ownership.

Testimony of
Preston R. Padden, President, Network Distribution,
Fox Broadcasting Company
before the
Senate Committee on Commerce, Science & Transportation
Tuesday, March 21, 1995

I. INTRODUCTION.

Thank you Mr. Chairman. My name is Preston Padden and I am President, Network Distribution of Fox Broadcasting Company. We are very appreciative of your leadership in moving the Congress forward on important new telecommunications legislation. In my testimony today, I hope to make the following points:

- First, today's television marketplace has become wildly competitive.
- Second, competition is a far better servant of the public interest than even the best intentioned regulation can ever be.
- Third, deregulation of broadcast station ownership will not harm the concept of "localism" since large group owners, including the networks, are leaders in local news.
- Fourth, because of new competitive forces, local affiliate stations have gained significant leverage in their relations with national television networks.
- Fifth, it is fundamentally anti-competitive for some group owners to seek to limit the size of other group owners.
- And sixth, it would be a tragedy, and would disserve the public interest, to streamline the Communications Act for wired media like cable and telcos that charge the American people while leaving free wireless broadcasting trapped in regulations that date back to 1927 -- regulations originally designed for a bygone era of scarcity.

For all of the foregoing reasons, Fox strongly supports the repeal of the existing statues and regulations that limit (1) the multiple ownership of broadcast stations nationally, (2) the ownership of more than one station in a single market and (3) the cross-ownership of broadcast stations and other media properties. The three other national television networks and many local television stations all across the country (including the 141 stations listed on Attachment No. 1 hereto) each in its own way and each to different extents all support deregulation of broadcast station ownership.

The following recent letter to Senator Burns from a small station operator in Montana states the deregulatory case with eloquent brevity:

March 8, 1995

The Honorable Conrad Burns
Dirksen Senate Office Building
Washington, DC 20510

Re: Strong Support for Television Ownership Deregulation

Dear Senator Burns:

As you know, the Senate is considering legislation to deregulate the ownership of television and radio stations. For reasons I cannot fathom some people in the television industry oppose such deregulation.

We are a small company with television stations in Billings and Miles City. I oppose ownership limits on general principal and because their practical effect is to artificially constrain the television market, limiting innovation and economies of scale. Conversely, limitations serve no public interest.

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Remember that whoever owns the stations will have the same public interest desires and requirements. The people in each market do not benefit from keeping out potential owners based on artificial criteria like number of stations.

Please support the absolute elimination of ownership limitations or the closest you can get to it.

Sincerely yours,

/ s /

Thomas Hendrickson
President
Big Horn Communications
KSVI-TV/Billings
KYUS-TV/Miles City

When the views of the many local television broadcasters like Mr. Hendrickson and the four national television networks are combined with the views of the Radio Board of Directors of the National Association of Broadcasters, it is clear that the weight of opinion in the radio and television industry strongly favors deregulation of broadcast station ownership. In addition, the views expressed in my testimony are supported by the attached economic and telecommunications policy paper ("The Evolving Electronic Media Marketplace and the Devolving Case for Broadcast Ownership Restrictions") authored by John Haring & Harry M. Shooshan, III which appears as Attachment No. 2.

II. TODAY'S TELEVISION MARKETPLACE HAS BECOME WILDLY COMPETITIVE.

In the old days, the television industry could best be described as a cozy and comfortable shared monopoly. There were only three networks, and most communities were served by only three stations. Because of the absence of competition, the business was highly regulated, highly profitable and virtually risk free. Fortunately for the viewing public, those days are gone forever.

Today's television marketplace is characterized by vibrant and increasing competition. It is a marketplace in which consumers enjoy a vastly expanded array of program choices. Advertisers enjoy a vastly expanded range of options for communicating their marketing messages. And, both major program producers and just some little guy with a good idea enjoy a vastly expanded range of options for bringing their creativity to the attention of American viewers. All of the new competition materially undermines the foundation of the broadcast ownership restrictions. Worse yet, as outlined in the attached paper by Haring and Shooshan, in the newly competitive environment, the broadcast ownership restrictions become worse that unnecessary. They become counter-productive.

The first source of new competition is UHF broadcasting. Throughout the 70's and 80's, hundreds and hundreds of new UHF television stations were established across the country. As a result, instead of only three local program choices, 95% of U.S. television households are now served by five or more local stations. Perhaps most importantly, the growth of these new UHF stations has provided a platform for the establishment of new national networks.

The emergence of new networks demonstrates that free market forces often can accomplish what bureaucratic regulators deem impossible or unlikely. In 1980, the FCC's expert staff spent taxpayers' dollars to issue a gloomy report which predicted that the growth of additional over-the-air networks was not likely in the then foreseeable future. Not believing that pessimistic prediction, our company and our principal, Rupert Murdoch, invested the capital and took the enormous risk necessary to establish a genuinely competitive fourth network. And, our success has prompted the Paramount/Chris-Craft partnership and the Warner Bros./Tribune partnership to launch two additional national broadcast networks.

The growth of new over-the-air broadcasting stations and networks represents only the tip of the iceberg of the new competitive forces in television. Ninety-six percent of U.S. television households are now passed by cable television systems and 63% subscribe. As a result, a majority of Americans now enjoy the choice of over 30 channels of television service -- a tenfold increase over the three channel era of yesteryear. Currently, the cable television industry supplies American viewers with more than 100 different network services. As cable converts from analog to digital, the number of channels and the number of program choices available to Americans will grow exponentially.

And, cable is not alone. SMATV services also provide more than a million Americans with access to diverse program sources. Wireless cable systems have attracted over half a million subscribers. By the end of this year, more than a million American households are expected to be receiving hundreds of channels of advanced digital television service from the Hughes/Hubbard direct broadcasting satellite. Later this year, Echostar will commence service from a second high powered digital direct broadcasting satellite. Just last week, Echostar announced that it had signed contracts with Turner, Disney, ESPN and numerous other program networks.

Finally, looming on the horizon are the largest economic forces ever to be unleashed in the television business -- the telephone companies. Just a few weeks ago in a living metaphor of the changes engulfing our industry, Howard Stringer, the President of CBS, quit his job to lead a television program alliance of three regional Bell companies. Mr. Stringer's defection from broadcasting formally signals the end of the era in which broadcast ownership regulation was relevant and productive. Simply stated, the tremendous level of competition and diversity in today's television industry bears absolutely no resemblance whatsoever to the era of scarcity in which the broadcast ownership restrictions were born. And, if free broadcasting has any hope of staying competitive with the new media, those ownership restrictions must be repealed.

III. COMPETITION IS A BETTER SERVANT OF THE PUBLIC INTEREST THAN EVEN THE BEST INTENTIONED REGULATIONS CAN EVER BE.

There is near universal agreement among public policymakers -- Republican and Democrat -- that real competition, when you can get it, is always a better servant of the public interest than is even the best intentioned regulation. The recent history of broadcast deregulation confirms this commonly accepted consensus. In 1984, the FCC loosened its regulations governing the ownership of multiple television stations. It was the hope and belief of the FCC, and of leading members of the United States Congress (including in particular Congressman Edward Markey), that permitting the creation of larger and economically stronger groups of commonly owned stations would foster competition and diversity in the industry. History shows that they were correct. In fact, the liberalization of the multiple ownership rules was a major contributing factor in the successful establishment of a fourth national television network. An expanded base of owned stations provided Fox with the foundation upon which to build a new competitive force. The resulting public interest benefits exceed anything that could have been accomplished by regulation.

General Diversity -- The growth of Fox provided viewers with new programming options and spurred the three older networks to become more aggressive and more innovative.

Children's Programs -- Fox brought children's programming back to weekday network television for the first time in 20 years and currently leads the industry with three hours per week of *bona fide* "educational-by-anybody's-definition" children's shows.

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Local News -- As a part of its competitive strategy -- and not because of any regulation -- the Fox stations present prime time local newscasts like the "10 O'Clock News" on WTTG in Washington. The number of Fox affiliates presenting prime time newscasts has increased from 15 to 50 in the last three years. In addition, Fox owned stations and Fox affiliates have begun to create local morning news and information programs like "The Fox Morning News" here in Washington. In fact, the New World owned stations recently switched from CBS to Fox and in the process virtually doubled the amount of their local news and information programming. Again, these tremendous public interest benefits were spurred by competitive opportunity -- not regulatory mandate.

Job Creation -- The new national network created by Fox, has created thousands of new jobs in the program production community.

Program Producers -- The new network created by Fox has provided an alternative market for program producers large and small. Appended to my testimony as Attachment No. 3, are letters recently sent to the FCC from two African-American producers attesting to the opportunities created by Fox.

Advertisers -- Fox also has provided commercial advertisers with a host of new competitive options for distributing their marketing messages.

The growth of cable also demonstrates the principle that competition is a better servant of the public interest than is regulation. Ted Turner's 24 hour news networks were created in response to competitive opportunity -- not regulatory mandate. The same is true of Bravo, Arts & Entertainment, Discovery and a host of other new cable networks.

Simply stated, the goal of diversity, which was the original premise for the broadcast ownership rules, has been achieved through competitive marketplace forces. As a result, continued regulation is no longer necessary. In fact, continued regulation disserves the public interest by inhibiting the over-the-air medium *vis-a-vis* other competitive media.

IV. DEREGULATION OF BROADCAST STATION OWNERSHIP WILL NOT HARM THE CONCEPT OF "LOCALISM" SINCE LARGE GROUP OWNERS, INCLUDING THE NETWORKS, ARE LEADERS IN LOCAL NEWS.

Repeal of the broadcast ownership rules would not pose any threat to the concept of localism or the amount of local programming on television stations. The objective facts demonstrate that large group owners, including the networks, are leaders in local news. In addition, the objective facts demonstrate that the amount of local programming in the industry has increased since the last relaxation of the broadcast multiple ownership rules.

In 1984, the National Association of Broadcasters conducted a study which compared the amount of local public service programming on group owned stations and on individually owned stations. The results of that study clearly demonstrated that group owned stations broadcast more local programming and more public service programming than do individually owned stations.

Following that study, the FCC relaxed its rules to permit increased multiple ownership of television stations. Since that deregulation, the amount of local news and information programming in the industry has increased. As noted above, increased local news programming has been a key part of the Fox competitive strategy. Many other group owners (including Sunbeam and New World) have increased local news broadcasts. A recent study by the Columbia University School of Journalism confirmed an increase in local public affairs programming on stations all across the country.

To provide the Committee with updated information regarding local news broadcasts, Fox surveyed the current programming of stations operated by four different group owners. The results of that survey are set forth below.

LOCAL NEWS HOURS PROGRAMMED PER WEEK

	Local News Hours Per Week
AFLAC BROADCAST DIVISION/ AMERICAN FAMILY BROADCAST GROUP	
Baton Rouge/WAFB	12
Cedar Rapids/KWWL	11
Columbus, GA/WTVM	12
Greenville, NC/WITN	11.5
Huntsville/WAFF	9
Paducah/KFVS	12
Savannah/WTOC	14.5
FOX OWNED & OPERATED*	
Chicago/WFLD	21.5
Houston/KRIV	13.5
Los Angeles/KTTV	22
New York/WNYW	23.5
Salt Lake City/KSTU	6
Washington/WTTG	24
NEW WORLD	
Atlanta/WAGA	36.5
Cleveland/WJW	39
Detroit/WJBK	36.5
Kansas City/WDAF	44
Milwaukee/WITI	42.5
Phoenix/KSAZ	34.5
Tampa/WTVT	38
ABC OWNED & OPERATED	
Chicago/WLS	23.5
Fresno/KFSN	12
Houston/KTRK	18.5
Los Angeles/KABC	24.5
New York/WABC	20
Philadelphia/WTXF	20.5
Raleigh/WTVD	14.5
San Francisco/KGO	21

*Excludes WATL and KDAF which are being sold.

As these numbers illustrate, large group owners, including networks, are leaders in the presentation of local news. In fact, network owned stations typically present more local news than do the stations owned by AFLAC -- a group owner that opposes deregulation. Plainly, there is no basis in fact for AFLAC's argument that the ownership of additional stations by networks would be contrary to the goal of localism.

V. BECAUSE OF NEW COMPETITIVE FORCES, LOCAL AFFILIATE STATIONS HAVE GAINED SIGNIFICANT LEVERAGE IN THEIR RELATIONS WITH NATIONAL TELEVISION NETWORKS.

There are many, many local broadcast stations that support deregulation of station ownership. However, there are some affiliate stations who argue that deregulation could upset what they describe as the "delicate balance" in the network/affiliate relationship. With all due respect, we believe that these affiliates (1) substantially understate the leverage that they enjoy *vis-a-vis* their networks and (2) suffer from exaggerated fears regarding the likely consequences of deregulation.

The objective facts demonstrate beyond any argument, that because of new competitive forces (and not because of the *status quo* ante), local affiliates have gained substantial leverage in their relationship with national television networks. In the old days of television scarcity, there were only three networks and only three stations (or at least only three strong stations) in most local markets. Imagining an analogy to the game of musical chairs, it is easy to see how with only three networks seeking distribution on only three stations, stations were not perceived as a premium commodity and did not enjoy substantial leverage. When the music stopped, each of the three existing networks would have a place to sit. As a result, compensation payments from networks to local affiliates declined and at least one network considered charging its affiliates a "franchise fee."

Because of aggressive competition from Fox, those dynamics have now changed radically. There are now more networks than there are strong desirable VHF stations in most markets. As a result, when the music stops, there are not enough desirable seats for each network. Consequently, the market value and leverage of station "chairs" has gone up dramatically. In market after market, the three older networks have moved aggressively to shore up their distribution by entering into long term affiliation agreements with vastly increased compensation payments to their stations. Because of new competitive forces, there has been a transfer of hundreds of millions of dollars of wealth from the three older networks to their affiliates in the last year alone. And, because of these new long term contracts, that transfer of wealth will be repeated in each of the next ten years. With the advent of the WB and UPN networks and other new programming services seeking distribution, the substantial leverage enjoyed by local affiliate stations is certain to grow even stronger in the future.

Based upon these incontrovertible facts, there is absolutely no basis to maintain station ownership regulations out of any fear for the need to protect local affiliate stations. They have the leverage. No one can make them sell their stations. And, the competition from new networks is acting as a competitive restraint on any pressure that one of the old networks might otherwise try to exert regarding program clearances.

VI. IT IS FUNDAMENTALLY ANTI-COMPETITIVE FOR SOME GROUP OWNERS TO SEEK TO LIMIT THE SIZE OF OTHER GROUP OWNERS.

Broadcasters operate in a competitive environment. We compete with each other as well as with other media. Group owners often compete with each other to purchase stations that are offered for sale.

We urge the Commerce Committee to be very careful in entertaining arguments from any group owners seeking to cap the growth of their competitors. It is absolutely true that if the largest groups are excluded from the bidding for future acquisition, the remaining group owners may be able to purchase stations at lower prices. But, this is a fundamentally anti-competitive objective.

VII. IT WOULD BE A TRAGEDY AND WOULD DISSERVE THE PUBLIC INTEREST TO STREAMLINE THE COMMUNICATIONS ACT FOR WIRED MEDIA SUCH AS CABLE AND TELCOS WHILE LEAVING WIRELESS BROADCASTING TRAPPED IN REGULATIONS DATING BACK TO 1927 -- REGULATIONS DESIGNED FOR A BYGONE ERA OF SCARCITY.

The legislation currently being considered will unleash tremendous new competitive forces within the television industry. Frankly, this is a prospect that is frightening to every station and network in broadcasting.

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Because of our fears, we could be sitting before you today, making protectionists pleas. We could easily conjure arguments why the pubic interest would be served by not fostering new competition. We could seek your protection against the onslaught of the telephone companies and other frightening new competitors. But, we're not doing that. All four major networks and many local stations accept the reality that the television business is going to get even more competitive and even more dangerous.

Our only plea is for reasonable symmetry in regulatory treatment and reasonable symmetry in opportunity. While smoothing the way to the 21st century for the wired media, don't turn you backs on broadcasting. Don't leave us in a regulatory straightjacket that dates back to 1927. We are not seeking protection but rather the freedom to compete.

There is a lot more at issue here than just our own economic well being. The public has an enormous stake in the decisions you make because we believe that broadcasting's greatest years still lie ahead. It is fundamentally wrong to perceive the local broadcaster as just another programmer seeking to take a ride on the information superhighway of tomorrow. If freed from outdated regulatory constraints and permitted to utilize the latest technology, plain old broadcasting can be transformed into a service rich wireless superhighway in its own right. With regulatory freedom, we can build a broadcast freeway to compete with the wired toll roads. Most importantly, local broadcasters can provide consumers with a wide array of video programming and other innovative services. And, our ubiquitous freeway can act as a strong marketplace constraint on the pricing of the wired toll roads.

Fox, the other networks and the many local broadcasters who support deregulation are not coming before you seeking protection. We believe that we can compete and serve the public interest if we are free to respond to the dynamic forces of our wildly competitive marketplace.

VIII. CONCLUSION.

The weight of opinion in the radio and television industry supports deregulation of broadcast station ownership. The television marketplace has become wildly competitive. That competition is a better servant of the public interest than even the best intentioned regulation could ever be. Deregulation of broadcast station ownership will not harm the concept of "localism" since large group owners, including networks, are leaders in local news.

Because of new competitive forces, local affiliate stations have gained significant leverage in their relationship with their networks. It is fundamentally anti-competitive for some group owners to seek to limit the size of other group owners. And, it would be a tragedy and would disserve the public interest to streamline the Communications Act for wired media while leaving wireless broadcasting trapped in an antiquated regulatory straight jacket.

For all of the foregoing reasons, we urge you to repeal the statutes and regulations restricting (1) the multiple ownership of broadcast stations nationally, (2) the ownership of more than one station in a single market and (3) the cross-ownership of broadcast stations and other media properties.

ATTACHMENT NO. 1

BROADCASTERS FOR COMPETITION & OWNERSHIP DEREGULATION

The following broadcasters, each in its own way, and each based on its own business strategies, support competition in broadcasting and deregulation of station ownership. The following list (though not inclusive of all broadcasters supporting deregulation) contains national networks and local television stations. When these television interests are combined with the strong de-regulatory sentiment of the Radio Board of the National Association of Broadcasters, it is clear that the weight of opinion in the radio and television industry favors competition and deregulation.

STATION	AFFILIATE	OWNERSHIP
ALBANY-SCHENECTADY-TROY		
WXXA-TV	FOX	CLEAR CHANNEL TELEVISION INC.
ATLANTA		
WGNX	CBS	TRIBUNE BROADCASTING CO.
WATL	IND	FOX TELEVISION STATIONS INC.
WTBS	IND	TURNER BROADCASTING SYSTEM, INC.
WAGA-TV	CBS	NEW WORLD COMMUNICATIONS GROUP
AUSTIN		
KXAN-TV KXAM-TV	NBC	LIN TELEVISION CORP.
KTBC-TV	FOX	ARGYLE TELEVISION HOLDINGS II INC.
BALTIMORE		
WJZ-TV	CBS	GROUP W -- WESTINGHOUSE BROADCASTING
WBFF	FOX	SINCLAIR BROADCAST GROUP INC.
WNUV	IND	ABRY COMMUNICATIONS
BILLINGS-MILES CITY		
[illegible]	ABC/FOX	BIG HORN COMMUNICATIONS INC.
KYUS-TV	ABC	BIG HORN COMMUNICATIONS INC.
BIRMINGHAM		
WTTO	ABC	SINCLAIR BROADCAST GROUP INC.
WVTM-TV	NBC	ARGYLE TELEVISION HOLDING II INC.
WBRC-TV	FOX	NEW WORLD COMMUNICATIONS GROUP
BOSTON		
WBZ-TV	CBS	GROUP W -- WESTINGHOUSE BROADCASTING
WLVI-TV	IND	TRIBUNE BROADCASTING CO.
WSBK-TV	IND	NEW WORLD COMMUNICATIONS GROUP

BUFFALO

WUTV	FOX	ACT III BROADCASTING INC.

BURLINGTON-PLATTSBURGH

WNNE-TV	NBC	HERITAGE MEDIA CORP.
WPTZ	NBC	HERITAGE MEDIA CORP.

CHAMPAIGN & SPRINGFIELD-DECATUR

WAND	ABC	LIN TELEVISION CORP.

CHARLESTON, SC

WTAT-TV	FOX	ACT III BROADCASTING INC.

CHARLESTON-HUNTINGTON

WVAH-TV	FOX	ACT III BROADCASTING INC.
WCHS-TV	ABC	HERITAGE MEDIA CORP.

CHARLOTTESVILLE, VA

WVIR-TV	NBC	WATERMAN BROADCASTING CORP.

CHICAGO

WLS-TV	ABC	CAPITAL CITIES/ABC
WBBM-TV	CBS	CBS INC.
WMAQ-TV	NBC	NATIONAL BROADCASTING CO.
WFLD	FOX	FOX TELEVISION STATIONS INC.
WGN-TV	IND	TRIBUNE BROADCASTING CO.

CINCINNATI

WXIX-TV	FOX	MALRITE COMMUNICATIONS GROUP INC.

CLEVELAND

WOIO	CBS	MALRITE COMMUNICATIONS GROUP INC.
WJW-TV	FOX	NEW WORLD COMMUNICATIONS GROUP

COLUMBIA, SC

WACH	FOX	ELLIS COMMUNICATIONS INC.

COLUMBUS, OH

WTTE	FOX	SINCLAIR BROADCAST GROUP INC.
WSYX	ABC	RIVER CITY BROADCASTING

DALLAS-FORT WORTH

KXAS-TV	NBC	LIN TELEVISION CORP.
KDFW-TV	FOX	ARGYLE TELEVISION HOLDING INC.
KDAF	IND	FOX TELEVISION STATIONS INC.

DAYTON

WRGT-TV	FOX	ACT III BROADCASTING INC.

DENVER

KCNC-TV	NBC	NATIONAL BROADCASTING CO
KDVR/KFCT	FOX	RENAISSANCE COMMUNICATIONS CORP
KWGN-TV	IND	TRIBUNE BROADCASTING

DES MOINES-AMES

KDSM-TV	FOX	RIVER CITY BROADCASTING

DELUTH

KBJR-TV	NBC	GRANITE BROADCASTING CORP

DETROIT

WJBK-TV	FOX	NEW WORLD COMMUNICATIONS GROUP

FARGO-VALLEY CITY

KBRR/KJRR/ KNRR/KVRR	FOX	RED RIVER BROADCAST CORP

FORT WAYNE

WANE-TV	CBS	LIN TELEVISION CORP
WPTA	ABC	GRANITE BROADCASTING CORP

FORT MYERS-NAPLES

WEVU	ABC	ELLIS COMMUNICATIONS INC
WBBH-TV	NBC	WATERMAN BROADCASTING CORP

FRESNO-VISALIA

KFSN-TV	ABC	CAPITAL CITIES/ABC INC
KMPH	FOX	PAPPAS TELECASTING COMPANIES
KSEE	NBC	GRANITE BROADCASTING CORP

GRAND RAPIDS-KALAMAZOO-BATTLE CREEK

WZZM-TV	ABC	ARGYLE TELEVISION HOLDING INC
WOOD-TV	NBC	LIN BROADCASTING CORP

GREEN BAY-APPLETON

WFRV-TV	CBS	CBS INC

GREENSBORO-HIGH POINT & WINSTON-SALEM

WNRW	FOX	ACT III BROADCASTING INC
WGHP-TV	ABC	NEW WORLD COMMUNICATIONS GROUP

GREENVILLE-SPARTANBURG-ASHEVILLE-ANDERSON

WAXA/WLOS	ABC	RIVER CITY BROADCASTING

HARRISBURG-LANCASTER-LEBANON-YORK

WPMT	FOX	RENAISSANCE COMMUNICATIONS CORP

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HARTFORD & NEW HAVEN

WTNH-TV	ABC	LIN TELEVISION CORP.
WTIC-TV	FOX	RENAISSANCE COMMUNICATIONS CORP.

HOUSTON

KTRK-TV	ABC	CAPITAL CITIES ABC
KRIV	FOX	FOX TELEVISION STATIONS INC.

INDIANAPOLIS

WTTV/WTTK	IND	RIVER CITY BROADCASTING
WISH-TV	CBS	LIN TELEVISION CORP.
WXIN	FOX	RENAISSANCE COMMUNICATIONS CORP.

JACKSONVILLE-BRUNSWICK

WAWS-TV	FOX	CLEAR CHANNEL TELEVISION INC.

KANSAS CITY

KSMO-TV	IND	ABRY COMMUNICATIONS
WDAF-TV	FOX	NEW WORLD COMMUNICATIONS GROUP

KERRVILLE-SAN ANTONIO

KABB-TV	IND	RIVER CITY BROADCASTING

KNOXVILLE

WTNZ	FOX	ELLIS COMMUNICATIONS INC.

LITTLE ROCK-PINE BLUFF

KLRT	FOX	CLEAR CHANNEL TELEVISION INC.

LOS ANGELES

KABC-TV	ABC	CAPITAL CITIES/ABC
KCBS-TV	CBS	CBS INC.
KNBC-TV	NBC	NATIONAL BROADCASTING CO.
KTTV	FOX	FOX TELEVISION STATIONS INC.
KTLA	IND	TRIBUNE BROADCASTING CO.

MARQUETTE-ESCANABA

WJMN-TV	CBS	CBS INC.

MEMPHIS

WMC-TV	NBC	ELLIS COMMUNICATIONS INC.
WPTY-TV	FOX	CLEAR CHANNEL TELEVISION INC.

MIAMI-FORT LAUDERDALE

WCIX	CBS	CBS INC.
WTVJ	NBC	NATIONAL BROADCASTING CO.
WDZL	IND	RENAISSANCE COMMUNICATIONS

MILWAUKEE

WCGV-TV	IND	SINCLAIR BROADCAST GROUP, INC.
WITI-TV	FOX	NEW WORLD COMMUNICATIONS GROUP

MINNEAPOLIS-ST. PAUL

WCCO-TV/KCCW-TV A		
WCCO-TV	CBS	CBS INC.
KITN-TV	FOX	CLEAR CHANNEL TELEVISION INC.

MOBILE-PENSACOLA

WPMI	FOX	CLEAR CHANNEL TELEVISION INC.
WEAR-TV	ABC	HERITAGE MEDIA CORP.

NASHVILLE

WZTV	FOX	ACT III BROADCASTING INC.

NEW ORLEANS

WGNO	IND	TRIBUNE BROADCASTING

NEW YORK

WABC-TV	ABC	CAPITAL CITIES/ABC
WCBS-TV	CBS	CBS, INC.
WNBC-TV	NBC	NATIONAL BROADCASTING CO.
WNYW	FOX	FOX TELEVISION STATIONS INC.
WPIX	IND	TRIBUNE BROADCASTING CO.

NORFOLK-PORTSMOUTH-NEWPORT NEWS

WAVY-TV	NBC	LIN TELEVISION CORP.

OKLAHOMA CITY

KOKH-TV	FOX	HERITAGE MEDIA CORP.

OMAHA

KPTM	FOX	PAPPAS TELECASTING COMPANIES

PEORIA

WEEK-TV	NBC	GRANITE BROADCASTING CORP.

PHILADELPHIA

WPVI-TV	ABC	CAPITAL CITIES/ABC
WCAU-TV	CBS	CBS INC.
KYW-TV	NBC	GROUP W -- WESTINGHOUSE BROADCASTING
WPHL	IND	TRIBUNE BROADCASTING CO.

PHOENIX

KSAZ-TV	FOX	NEW WORLD COMMUNICATIONS GROUP

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PITTSBURGH

KDKA-TV	CBS	GROUP W -- WESTINGHOUSE BROADCASTING
WPGH-TV	FOX	SINCLAIR BROADCAST GROUP INC

RALEIGH-DURHAM

WTVD	ABC	CAPITAL CITIES/ABC INC
WLFL	FOX	SINCLAIR BROADCAST GROUP INC

RAPID CITY

KCLO-TV	CBS	MIDCONTINENT TELEVISION OF SOUTH DAKOTA
KEVN-TV/KIVV-TV	NBC	HERITAGE MEDIA CORP.

RENO

KAME-TV	FOX	ELLIS COMMUNICATIONS INC

RICHMOND-PETERSBURG

WRLH-TV	FOX	ACT III BROADCASTING INC

ROCHESTER, NY

WUHF	FOX	ACT III BROADCASTING INC.

ROCKFORD

WQRF-TV	FOX	PETRACOM INC.

SACRAMENTO-STOCKTON-MODESTO

KOVR	CBS	RIVER CITY BROADCASTING
KTXL	FOX	RENAISSANCE COMMUNICATIONS CORP
KPWB-TV	IND	PAPPAS TELECASTING COMPANIES

SALT LAKE CITY

KSTU	FOX	FOX TELEVISION STATIONS INC.

SAN DIEGO

KNSD	NBC	NEW WORLD COMMUNICATIONS

SAN FRANCISCO-OAKLAND-SAN JOSE

KGO-TV	ABC	CAPITAL CITIES/ABC
KPIX-TV	CBS	GROUP W -- WESTINGHOUSE BROADCASTING
KNTV	ABC	GRANITE BROADCASTING CORP.

SIOUX FALLS-MITCHELL

KDLO-TV/KELO-TV & KPLO-TV	CBS	MIDCONTIENENT TELEVISION OF SOUTH DAKOTA
KTTW/KTTW	FOX	INDEPENDENT COMMUNICATIONS INC
KDLT	NBC	RED RIVER BROADCAST CORP.

ST. LOUIS

KDNL-TV	ABC	RIVER CITY BROADCASTING
KTVI	FOX	ARGYLE TELEVISION HOLDING INC.

SYRACUSE

WTVH	CBS	GRANITE BROADCASTING CORP.

TAMPA-ST. PETERSBURG-SARASOTA

WTTA	IND	SINCLAIR BROADCASTING GROUP INC.
WTVT	FOX	NEW WORLD COMMUNICATIONS GROUP

TOLEDO

WUPW	FOX	ELLIS COMMUNICATIONS INC.

TUCSON

KTTU-TV	IND	CLEAR CHANNEL TELEVISION INC.

TULSA

KOKI-TV	FOX	CLEAR CHANNEL TELEVISION INC.

WASHINGTON, D.C.

WRC-TV	NBC	NATIONAL BROADCASTING CO.
WTTG	FOX	FOX TELEVISION STATIONS INC.

WEST PALM BEACH-FORT PIERCE

WFLX	FOX	MALRITE COMMUNICATIONS GROUP INC.

WICHITA-HUTCHINSON

KAAS-TV/KSAS-TV	FOX	CLEAR CHANNEL TELEVISION INC.

ABRY Communications
Act III Broadcasting, Inc.
Argyle Television Holding II, Inc.
Big Horn Communications, Inc.
Capital Cities/ABC Inc.
CBS Inc.
Clear Channel Television, Inc.
Ellis Communications, Inc.
Fox Television Stations, Inc.
Granite Broadcasting Corp.
Group W -- Westinghouse Broadcasting
Heritage Media Corp.
Independent Communications Inc.
Lin Television Corp.
Malrite Comm. Group, Inc.
Midcontinent TV of S. Dakota
National Broadcasting Co.
New World Communications Group
Pappas Telecasting Companies
Petracom, Inc.
Red River Broadcast Corp.
Renaissance Communications Corp.
River City Broadcasting
Sinclair Broadcast Group, Inc.
Tribune Broadcasting
Turner Broadcasting System, Inc.
Waterman Broadcasting Corp.

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ATTACHMENT NO. 2

The Evolving Electronic Media Marketplace
and the Devolving Case for
Broadcast Ownership Restrictions

STRATEGIC
POLICY
RESEARCH

[illegible] GEORGETOWN ROAD SUITE [illegible] BETHESDA, MARYLAND [illegible]

The Evolving Electronic Media Marketplace and the Devolving Case for Broadcast Ownership Restrictions

John Haring

Harry M. Shooshan III

March 20, 1995

About the Authors

John Haring and Chip Shooshan are principals in Strategic Policy Research, Inc., an economics and telecommunications policy consulting firm located in Bethesda, Maryland. Dr. Haring formerly served as Chief Economist and Chief, Office of Plans and Policy, at the Federal Communications Commission. Mr. Shooshan formerly served as Chief Counsel and Staff Director for what is now the Subcommittee on Telecommunications, U.S. House of Representatives.

STRATEGIC
POLICY
RESEARCH

Introduction

Exploding competition in the electronic media marketplace has rendered government broadcast ownership restrictions obsolete, but not irrelevant as their continuation is unfortunately likely to prove hazardous to the consuming public's health. Ownership restrictions have long since stopped being part of the solution; now they are fast becoming part of the problem. Conceived in an era when scarcity of electronic media outlets was the watchword, the government's ownership restrictions were originally designed to encourage diversity of ownership and to safeguard against undue concentration of economic power. In a world where there were only a few outlets, taking steps to ensure adequate competition among the few made some sense. In a world where technology and the market have vastly expanded the number of competing sources of information and entertainment and done more to promote competition and diversity than even the most extreme regulation could ever have contemplated, the old rules now lack a reason. What is worse, they have become incoherent and operate primarily to stifle the effective delivery of diverse programming *via broadcast technology*, including news and public affairs programming.

Not Kansas Anymore

The radical changes which have transformed the video marketplace during the last quarter century have become a commonplace in the print and electronic media. It has become almost impossible to avoid seeing a daily report regarding the introduction of some new communications technology or service that promises to deliver more for less. The basic facts are by now familiar to everyone: The selection and distribution of video programming is no longer anything even remotely resembling an oligopoly with only three primary network players.

Over the last twenty-five years, the video landscape has been radically transformed by a variety of interrelated economic and technological developments. These include remarkable growth in the *number* of conventional broadcast television stations, a huge expansion in the *amount* of programming delivered by cable and other distribution media, and extensive household *penetration*

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[1] In 1984, the Federal Communications Commission tentatively concluded that "explosive growth and change" in the mass media market supported a phase-out of national ownership limits. *See Amendment of Multiple Ownership Rules* (General Docket 83-1009) 100 FCC 2d 17, 18 (1984), *recon. granted in part* 100 FCC 2d 74 (1985).

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by VCRs and now PC technology. Indeed, conventional video and interactive software sales and rentals now far exceed the revenues of *all* broadcast and basic cable networks.

In 1970, there were only 62 independent television stations (*viz.*, those not affiliated with ABC, CBS or NBC) operating in the United States. By 1993, that number had grown to 438, a remarkable *sevenfold* increase. The simultaneous growth in cable television penetration played a significant role in the growth of independent television. Most independent stations operate in the UHF spectrum band and, as a consequence, are technically disadvantaged in their ability to reach large audiences. Carriage by cable television systems substantially reduces these technical disadvantages and permits UHF stations to be more competitive in acquiring desirable programming and producing larger audiences. According to the FCC, there were on average more than four times as many independent television stations operating in the top-50 markets in 1994 than in 1970.

The economic viability of independent television stations has furthermore enabled the formation of new *broadcast* networks to compete with the established networks. The Fox Broadcasting Company now is able to supply new network programming to nearly 200 affiliates (including secondary affiliates) and currently reaches 98.7 percent of the national audience. In addition to Fox, the United Paramount Network (UPN) recently commenced operations. It is offering two hours of programming two nights per week through 96 affiliates with coverage of about 79 percent of the total audience. The WB Television network (Warner Brothers) also began operations earlier this year. It is offering programming one night a week with plans to expand to additional nights in the future. WB Television reaches about 80 percent of the audience through a combination of approximately 50 local broadcast affiliates and the superstation WGN.

The entry of new broadcast networks has not only brought additional competition for audiences, advertising sales and programming, but for local market affiliates as well. Just a few years ago, CBS attempted to reduce its affiliates' compensation and restructure its relationship with its affiliates. The entry of new networks would make that idea suicidal for a network today. What had been a buyers' market has now clearly become a sellers' market. Potential affiliates are sitting in the proverbial driver's seat, and networks are scrambling to solidify the base of affiliates which,

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In addition to independent stations, the FCC has also authorized the operation of a large number of low-power television stations. Today more than 1,500 such stations offer service.

along with owned and operated stations, constitutes a critical component of a network's economic structure. While the number of potential video distribution channels to consumers is now virtually unlimited as a result of advances in technology, the number of conventional broadcast station licenses is limited by the amount of spectrum allocated to the service. With a limited number of outlets and a growing number of commercial networks clamoring for effective local market distribution, station leverage has grown significantly and is likely to continue to grow.

Following Fox's acquisition of broadcast rights to NFL football games, there have been numerous shifts in network affiliation. In December 1994, *Broadcasting & Cable* reported that 68 changes in affiliation had occurred in 37 markets. The benefits produced by this new environment have benefitted all affiliates. The networks have had to improve the compensation they pay in order to retain valuable affiliates and it has been estimated that, as a result, compensation rewards have risen by several hundred million dollars.

During the 1980s cable television became a communications industry giant in the United States, substantially increasing its market penetration, vertically integrating extensively into program production and supply, competing for local and national market advertising sales, and currently poised to enter the market for telephone service. Cable now passes by over 91 million households (about 97 percent of all television households) in the United States, and its market penetration is now about 63 percent of television households. The vast majority of cable subscribers now receive 30 or more channels, and nearly 40 percent receive 54 or more channels. Cable offers a large number and variety of program services. In 1994 there were 79 basic cable networks and 30 national non-basic service networks. There are also a large number of regional cable networks.

Broadcast and cable are not the only means by which video programming is distributed to consumers. More than two million households now receive programming utilizing backyard dishes, acquiring services via subscription as well as availing themselves of numerous free services. SMATV services are utilized by another million subscribers, and wireless cable (MMDS) has attracted over a half million subscribers. Recently direct broadcast satellite systems (DBS) began offering technically very high-quality services and it is estimated that these services will attract more than one million subscribers in 1995.

Looming large on the fringes of the market are the telephone companies. The telephone companies pose a very highly credible competitive threat because of their specific identities, the technology they are capable of deploying, the technological evolution their networks are undergoing for reasons apart from video distribution, and, last but by no means least, their financial strength and perceived staying power. In 1993, the seven Regional Bell Operating Companies (RBOCs) and GTE had combined revenues in excess of $100 billion. All of the major telephone companies in the United States have plans to enter the video distribution business, and several are currently striving mightily to do so in the face of heavy cable industry opposition, opposition which speaks for itself in terms of the perceived strength of the competition telephone companies are expected to bring to bear.

Recently three of the RBOCs (Bell Atlantic, Nynex and Pacific Telesis) announced the formation of a joint venture, capitalized initially to the tune of $300 million, for the express purpose of developing entertainment, information and interactive programming for new telco video distribution systems. This group has hired Howard Stringer, formerly of CBS, to head the venture and Michael Ovitz of Creative Artists Agency of Los Angeles to advise on programming and technology. A key aspect of this effort is development of navigator software that eventually could replace VCRs and remote control units to help customers find programs and services. Three other RBOCs (BellSouth, Ameritech and SBC Communications) are forming a joint venture with Disney, with a combined investment of more than $500 million during the next five years. The goal of this venture is specifically to develop, market and deliver video programming.

On top of all this activity involving the creation of new distribution paths and delivery of new entertainment and information services to the home, there has been a simultaneous revolution in the sophistication of the communications equipment employed in the home. Today more than 84 million U.S. households have VCRs. In 1994, U.S. households spent as much money purchasing and renting videos ($14 billion) as the combined revenues of all basic cable ($4.6) and the three established broadcast networks ($9.4) in 1993. In 1994, 37 percent of U.S. households owned personal computers. In 1993, estimated retail sales of North American computer software sales were $6.8 billion.

In addition to the purchase and rental of video and information software, recent years have witnessed rapid growth in information services. For example, between 1990 and the end of 1994, the number of subscribers to the top five on-line information services (Prodigy, CompuServe, America On-line, Delphi and GEnie) grew from 1.7 million to 5.58 million. The World Wide Web, which offered access to 130 Internet sites in June 1993, connected 12,000 sites at the beginning of 1995. By one estimate there are 50 to 100 new sites added to the World Wide Web each day. According to one estimate, revenue generated by electronic databases grew by nearly 60 percent between 1992 and 1993, and revenue from consumer on-line services increased by 23 percent during the same period.

To summarize, we are, as has been almost universally remarked, in the midst of an information revolution. That revolution is being driven by advances in microelectronic and fiber optic technology that give no evidence of abating. These advances are transforming virtually *all* marketplaces. Perhaps not surprisingly, the communications marketplace itself is an environment where Information Age change has become particularly manifest. In communications there are two generic "Wow!" charts: One shows productive capabilities rising exponentially with time, and the other shows costs falling exponentially with time. What does that portend, concretely, in the picture we have painted? The answer: Ever expanding and intensifying competition among more and more different types of programming (software) and information services, more and more closely matched to specifically what consumers want, delivered in any of an increasing variety of ways, and, in particular, the specific manner any particular consumer finds most economical and convenient at any particular time.

Harms from Outdated Regulation

To the extent that regulations are perceived as a substitute for competition, the evolution of effective competition obviously mitigates the need for the regulations. Thus, while there may be a need for new regulations to cope with new types of problems posed by the ongoing revolution in communications technology and services (*e.g.*, privacy issues), to the extent that the historical rationale for electronic mass media regulation has been scarcity, concentration and lack of

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competition, that rationale has been thoroughly undermined by a radical transformation of the industry structure that cannot be denied.

The fact that old regulations are rendered irrelevant in terms of their initial and motivating premises does not, however, mean that their continued existence is without material consequence. What frequently happens — and what we think has happened in the case of the government's broadcast ownership restrictions — is that the result of a failure to reform outmoded regulation is to transform the regulation into a barrier to competition as opposed to a foundation for competition. Instead of protecting consumers, outmoded regulations become a source of potential harm to consumers.

Whether the existence of such barriers matters turns in part on the extent and intensity of competition. Where competition is universal and unyielding, the consequence of a failure to reform is localized to the specific sector whose ability to compete effectively has been effectively restricted. Where competition is otherwise fully effective, the (perverse) effect of the regulation in this circumstance is to disable particular competitors relative to the competition. This poses an issue of equity: Why unfairly restrict the ability of one of many types of competitors to compete effectively? In the absence of otherwise fully effective competition, the perverse effect of outmoded regulations is not only to unfairly harm particular competitors, but to harm consumers as well.

As we have previously detailed, the broadcasting industry has become significantly more competitive during the last twenty-five years and, even more significantly, no longer operates in a competitive vacuum in terms of the existence of alternative video distribution media. It faces increasingly strong competition from a variety of technologically adept, marketing-savvy, financially high-powered competitors. These rivals are deploying pristine new, state-of-the-art networks and financing new programming ventures to produce both conventional and new interactive program material. If free broadcasting is going to remain an economically viable and effective distribution alternative, it is obviously going to have to keep pace. It is going to have to find a way to marshal the large amounts of financial capital necessary to upgrade its technical facilities, and it is going to have to be able to deliver competitively effective program material that either it produces itself or can acquire from independent sources that find broadcasting a sufficiently attractive medium to utilize to reach audiences.

The problem in a nutshell is that the station ownership rules restrain broadcasters from achieving the kinds of competitive synergies that other media can exploit effectively as a matter of course. These constraints limit the large infusion of capital that is needed to ensure competitive parity and the effective exploitation of productive synergies. Broadcast commenters in the FCC's ownership proceeding uniformly argued that increased group ownership would foster more intense competition by permitting broadcasters to achieve economies of scale that would enable them to better compete with cable, which enjoys a dual revenue stream from subscribers as well as advertisers, not available to over-the-air television

Restrictions on consolidation of stations in local markets would similarly allow more efficient operations. The theoretical common sense arguments are that there would be significantly beneficial consequences in terms of operating efficiencies if greater resource sharing in terms of administration, marketing and technical facilities could be achieved. Again these are the types of efficiencies that other competitors, notably cable, are permitted to exploit. It is ironic that regulations adopted initially to promote competition and increase diversity now operate to restrict competition and limit diversity

Absence of Downsides

Repeal of restrictions on multiple station ownership does not constitute repeal of the antitrust laws. Mergers and acquisitions of broadcast properties, whether national or local, would remain subject to the full panoply of antitrust enforcement tools. It is striking to observe the extent to which the FCC, in analyzing its ownership restrictions, is essentially *duplicating* the analysis the antitrust agencies would, in any event, conduct were an actual merger or acquisition proposed. The difference is that the FCC is fruitlessly trying to arrive at an answer in advance and on a generic, rather than a specific, basis. Whether any particular consolidation will pass competitive muster will necessarily depend on prevailing market conditions in particular market circumstances. To the extent that the FCC is evaluating issues the antitrust agencies could and, presumptively, would be evaluating anyway, its evaluation is simply redundant and unnecessary for reasons other than its own bureaucratic imperatives. However, if competition is the issue, the fact that the another part of the government will continue to worry the issue ought to constitute sufficient reason for this part of the government not to have to worry the issue.

The claims of certain network affiliates that community-oriented broadcasting would somehow be threatened are hard to credit seriously, and conflict with observed reality. In the first instance, voluntary exchange is *always* mutually beneficial to the transacting parties. Relaxation of restrictions on voluntary transactions does not *compel* traders to trade; it merely affords parties greater freedom to consummate trades if that is their evaluation of where their self-interests lie. If an affiliate wants to retain its existing ownership status, there is nothing to prevent it from so doing if restrictions on purchases and sales are relaxed.

Some affiliates argue that network ownership skews programming adversely from a public interest standpoint. This is not at all clear. While a network may be able to exert more direct and immediate pressure on management of an owned station to clear network programming and minimize local preemptions, the owned station will be strengthened in other ways by network resources and the observed net impact has heretofore been an expansion of locally originated programming. For example, Fox's owned stations have undertaken to offer an hour of local news at the conclusion of its network feed as well as additional local newscasts during non-prime time. Fox's network rivals in Washington have also expanded their local news coverage, now offering three hours of late-afternoon, early-evening news. All of the Washington network O&Os and affiliates are now offering an early-morning local news show. It should also be noted that network clearance does not imply that local programs of particular interest will not, in fact, be delivered. They may simply be carried on other stations. Thus, for example, Channel 50 in the Washington market now carries ACC and Big East basketball games previously transmitted on network stations.

The limited relaxation of the ownership rules heretofore adopted by the FCC which established a twelve-station limit up from seven provides some relevant evidence on the consequences of multiple station ownership for programming. It would certainly be hard to sustain the argument that this change had *any* adverse competitive impact along *any* relevant performance dimension. To the contrary, this relaxation, among its other beneficial impacts, permitted Fox to establish a sufficient base of stations to facilitate the formation of a fourth network. The entry of Fox and other networks not only strengthened the bargaining position of stations as previously discussed, but it also strengthened the performance of both its owned and operated stations (through exploitation of economies of scale and local program upgrades) and those stations that chose to become affiliates (which were, as a result, also empowered to upgrade their programming).

Those who maintain that expanded network station ownership will reduce locally originated programming need to explain why previous relaxation of ownership restrictions has apparently *not* had that consequence. Network and group-owned stations typically do *more* local news and public affairs programming.[4] The result of previous reform has apparently been more networking *and* more locally originated programming as well. Networking can create stronger local broadcast operations, and multiple station ownership can help facilitate the formation of competitively viable networks in an era of universal multimedia competition.

The notion that networking[3] and localism are in fundamental conflict is only an assertion and seemingly belied by the actual facts. A recent National Association of Broadcasters survey underscores an increasing commitment to television news. According to the survey results (reflecting a 69 percent response rate among commercial television stations), news programming costs for ABC, CBS and NBC affiliates were up 4.8 percent in 1993 at a time when other expenses were being cut 1.6 percent. News costs for Fox affiliates were up 23.4 percent while other expenses decreased 4.6 percent. Stations are doing more local news and public affairs programming because it is in their economic interests to differentiate themselves in the local television market and to be competitive.

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[3] The number of Fox stations presenting prime-time newscasts in their communities has increased from 15 to 50 in the last three years. Many Fox stations are also creating *local* morning news and information programs.

[4] In 1984, the National Association of Broadcasters conducted a study of 107 group- and nongroup-owned commercial television stations in 29 markets. (*See* "Public Service Programming By Group-Owned and Non Group-Owned Television Stations," January 1984.) The percentages of a broadcast day (6:00 a.m. through 12:00 midnight) devoted to three categories of public service programming were measured using *TV Guide* listings for a randomly-selected composite week. The results of the study indicated that overall, group-owned stations offer more public service programming than nongroup-owned stations. Group-owned stations devoted 18.4 percent, 10.1 percent and 32.0 percent of an average broadcast day to informational, local and total nonentertainment programming. Nongroup-owned stations devoted 12.9 percent, 6.9 percent and 24.8 percent of a broadcast day to these same program categories.

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Conclusion

The United States is today the most information-rich society in history. The idea that there are but few paths to achieve the attention of citizen/consumers is thoroughly belied by the radical *competitive* transformation of the communications marketplace that has occurred during the last quarter century *and is even now accelerating*. We suffer from neither a scarcity of independent communications paths nor one of salient messages. The restrictions on broadcast station ownership that remain in effect are a vestige of a world that no longer exists. Their survival in a new world to which they are ill adapted serves mainly to inhibit the competitive effectiveness of broadcasting relative to other communications media.

ATTACHMENT NO. 3

February 23, 1995

William F. Canton
Acting Secretary
Federal Communications Commission
1919 M Street, NW
Washington, DC 20554

Re: Application of Fox Television Stations Inc. for renewal of license for Station
WNYW-TV, New York, NY
File BRCT 940201KZ

Dear Mr. Canton,

My name is Samm-Art Williams. I am currently, the Executive Producer of the Martin Show, on Fox Television. My resume is attached.

Mr. Canton, I grew up in North Carolina during segregation, degradation and man's inhumanity to man. I was colored and Negro, long before I became African American. I have seen educated, qualified Americans, forced to feed their families on a servants pay, just because of the color of their skin.

As a ten year old, I discovered that I wanted to become a writer. Day after day, I would watch television, with not a single show to give me inspiration. Not a single writer, producer, stage manager or production person, that I could aspire to emulate. The doors were closed. But in my heart... the glass was always half full, rather than half empty.

Thanks to Fox Television and opportunities afford African Americans by this network, ten year old aspiring writers and producers can now say... "Maybe one day I can write for Martin. Maybe one day I can produce for Living Single. Maybe one day I can be stage manager for House of Buggin. Maybe one day I can create another Roc. Maybe one day I can be the Executive Producer of a show like Martin." How wonderful it is for ten year olds to be able to dream and aspire without boundaries.

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I feel very strongly about Fox Television's commitment to America... "The melting pot." And I strongly support the expansion of this network both locally and nationally. Renewal of license for station WNYW, New York, is very important. It'll help a lot of people.

Thank you.

Samm-Art Williams

The Honorable Reed E. Hundt
Chairman

The Honorable James H. Quello
Commissioner

The Honorable Andrew C. Barrett
Commissioner

The Honorable Rachelle B. Chong
Commissioner

The Honorable Susan Ness
Commissioner

William E. Kennard, Esq.
General Counsel

Renee Licht, Esq.
Acting Deputy Chief

UNIVERSAL TELEVISION 100 UNIVERSAL CITY PLAZA UNIVERSAL CITY CALIFORNIA 91608

Direct Dial Number

818-777-3265

February 22, 1995

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW
Washington, D.C. 20554

Re: Application of Fox Television Stations, Inc. for Renewal of License for Station WNYW-TV, New York, N.Y., File BRCT-940201KZ

Dear Mr. Caton:

I am writing on behalf of Fox Television Stations, Inc. ("Fox Network"), and in particular, on behalf of the television show "New York Undercover" which airs on the Fox Network.

Because of the conviction that the Fox Network has to minority broadcasting, I, as an African-American, find myself in a rare position in the film and television industry. Through the medium, I am able to express ideas, opinions, and tackle themes, ethnic and otherwise, which would never reach the American public unless someone was willing to take an enormous risk. The risk-taker in this instance is the Fox Television Network.

I feel that the programming efforts of Fox Television are beneficial and crucially necessary to every aspect of American society. It has been my goal and quest on "New York Undercover" to bring our minority characters "into the light," so to speak, to American viewers. The idea of "New York Undercover," two ethnic leads doing undercover police work in New York City, was and remains progressive. There is a thirst and hunger in our society for greater understanding and insights into the multi-cultural fabric that is the heart and soul of America. After a long, long

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diet of mush and oatmeal, the country yearns for jambalaya, red beans and rice and good old-fashioned down home cooking.

We strive to be less generic in the presentations of our characters and Fox encourages, rather than hinders us. Maybe this is why we are currently nominated for a People's Choice Award as "Favorite New Show." Everyone will suffer dearly if the Fox Network is not allowed to continue their innovative programming. I feel like they are doing something extremely important and others share that belief as well. It is certainly the case regarding "New York Undercover." I have taken tours of elementary schools around the country and worked with the Los Angeles Police Department in programs to help troubled youths. I would say the single greatest root of the frustrations of these youths is lack of self-esteem, self-worth and self-respect and the feeling of lack of representation in our society. Not surprising, virtually every one of these youths is familiar with, relates to, and identifies with my show, "New York Undercover," and other Fox shows, such as "Living Single," "House of Buggin'" and "Martin" because these youths get an opportunity to finally see themselves represented in society. That is to say, in the depiction of characters similar to themselves, they feel that they count...their lives actually mean something. Many of the kids I have spoken to see a ray of hope that they can transcend their environment and be legitimate participants in the American dream just because shows like ours exist and send the message: "You can do it if you try."

At the other end of the spectrum, because the Fox Network has encouraged us to put quality and integrity into our show, I feel that we attract a significant percentage of viewers who would otherwise never get a glimpse of the other cultures that exist virtually in their back yards. What they're used to seeing regarding minorities is what appears on the evening news... gangs, gunfire, rapes, etc., etc., etc. The Fox Network in many ways is a "stereotype" buster because they show ethnic characters closer to reality. In this light, how can a show not be beneficial in its telling of the struggles of a young black man in America, the struggles of a young Hispanic in America or, in the case of "Living Single," young singles looking for love, who happen to be African-American.

It is unfortunate that we must call this kind of programming daring. I believe the shows I've mentioned serve to link the universaility of all cultures. These shows need to be aired at all costs. I pray it continues.

Very truly yours,

Kevin Arkadie,
Creator/Producer,
"New York Undercover"

KA:hm
cc: The Honorable Reed E. Hundt
Chairman, FCC

The Honorable James H. Quello
Commissioner, FCC

The Honorable Andrew C. Barrett
Commissioner, FCC

The Honorable Rachelle B. Chong
Commissioner, FCC

The Honorable Susan Ness
Commissioner, FCC

William E. Kennard, Esq.
General Counsel

Renee Licht, Esq.
Acting Deputy Chief

The CHAIRMAN. Thank you, very much.
Mr. Jim Waterbury, chair, NBC Affiliates Association,
President and General Manager, KWWL TV, Waterloo, Iowa.

STATEMENT OF JIM WATERBURY, CHAIR, NBC AFFILIATES ASSOCIATION; PRESIDENT AND GENERAL MANAGER, KWWL TV

Mr. WATERBURY. Thank you, Mr. Chairman, good morning. Good morning to the members of the committee. I am here today representing NASA, which is the network affiliates.

The CHAIRMAN. Pull that microphone right up.

Mr. WATERBURY. Certainly. Thank you, Mr. Chairman. I am here representing today NASA, which is the Network Affiliated Station Alliance. We represent more than 600 television stations affiliated with the ABC, CBS, and NBC networks. These local broadcasters are, for the most part, small businesses that broadcast local programs of all kinds, local sports, news, political debates, election night coverage, charity telethons, as well as network and syndicated programming, as coverage to our communities.

The business of being a local affiliate television station is a separate and distinct business from operating a television network. Broadcast affiliates are Main Street businesses. Our smallest members may employ fewer than 50 people; our largest members may employ more than 300. But we all provide the same basic service. We serve our local viewers with the best blend of programing that we can provide. Most NASA affiliates have been providing continuous service to our community, to our viewers, for 40 years.

NASA members have worked hand in hand with our networks for decades. Together, we have created a free, universal system that no other television system begins to match. That system now serves more Americans than are served by telephones, and today meets many of the lofty goals that are held out for the information superhighway someplace on the future. We want to see that system continued, even if it means opposing our network partners on this one issue of ownership.

Like all broadcasters, we do favor deregulation in a number of areas, such as financial syndication rules, prime time access rules, and the numbers of stationed owned, but there are two areas where we believe that the current rules make great sense, and in fact do serve the public. And that is why I am here today, because these local television broadcasters asked me to deliver to you the following message: Your local broadcasters want to remain local broadcasters. The rules defining the relationship between the networks and the affiliates have served our Nation well by promoting localism, diversity, and universal availability of over-the-air broadcasting. Yet the proposals under discussion to abolish the cross-ownership prohibitions or to significantly increase the national audience caps would severely damage our ability to continue as local broadcasters. We disagree with abolishing cable cross-ownership restrictions or significantly altering the network ownership cap, both for public policy and for business reasons.

Our public policy concerns include maintaining a diverse number of competitive voices in the market, maintaining free universal access to first-run and first-rate programming, avoiding an unanticipated but inevitable concentration of power in New York and Hollywood, particularly as part of a new American agenda focused on moving power back to the States and to the people that we serve.

Our business issues concern maintaining a reasonable balance with our network partners, partners that already control 25 percent of the country through station ownership, 75 percent of the programming day of the typical network affiliate, and the next 7 to 10 years of those affiliates' program schedules under new, long-term contracts. We must maintain checks and balances to preserve this system. Our business issues also concern maintaining a reasonable balance with the cable companies that act as a gatekeeper to some 65 percent of America's homes. The simplest, surest way to maintain that balance is to continue the cable cross-ownership prohibitions.

Finally, we must ask who would be served by such changes? Certainly not the individual viewer nor the broadcaster nor the country as a whole; rather, only the networks and the cable companies would be served by these changes. I know that some in Washington are arguing that rules in place will protect affiliates with their dealings with the networks. That may sound appealing in Washington, but let me tell you my experience as a broadcaster operating this station in Iowa.

I face regular struggles with the networks daily on preempting network programs for network coverage—for local coverage, excuse me—whether it is a local sports event or a charitable fund-raiser. The idea that there may be rules in Washington provides little comfort when you have to go head to head with the network organization for a decision that must be made now. Also, the committee should realize that networks do not need these rule changes to compete with telephone or cable companies. In fact, it is just as likely that the network someday will be the telephone or cable companies. And so you have to ask whether anyone, a network, a phone company, a cable company, or a foreign-owned company, should have the kind of concentrated power that would be permissible and inevitable if these rules were not, in fact, in place.

There is one final point that I need to address. Those who need to justify a bare grab of power are attempting to wrap themselves in the mantle of deregulation. These proposals are being sold as deregulatory, when in fact they would simply concentrate power in the hands of the networks, and in fact be anticompetitive to this system. My friend here from the Fox network will admit that it would have next to impossible for the Fox network to get on the air if the national and local ownership rules he is attacking now had been abolished just 10 years ago. The Fox network has been good for affiliates and good for the public, but let us not destroy the chance for another Fox network to begin.

In short, the ownership rules were put in place to facilitate the development of a competitive television broadcast service, one that is owned by many companies, one that provides wide range and diversity of programming judgments and decisions at the local level.

A repeal of these rules by Congress would be a giant leap backwards, and a repeal of these rules with their simplicity and efficiency of administration would be counterproductive to the goal of this committee to reduce waste and efficiency in government.

Mr. Chairman, thank you.

[The prepared statement of Mr. Waterbury follows:]

STATEMENT

of

Jim Waterbury

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(NASA)

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SUMMARY

NASA represents the more than 600 local television stations affiliated with the ABC, CBS, and NBC networks. NASA members broadcast local sports, news, political debates, election night coverage, and charity telethons. These broadcasters seek to send one message to the Committee: Let local broadcasters be **local** broadcasters.

The rules defining the relationship between the networks and the affiliates promote localism, diversity, and universal availability of over-the-air broadcasting. Yet the proposals under discussion to abolish the cross-ownership prohibitions or significantly increase the national audience caps would severely damage localism. If too much power is placed in the hands of the networks, then the balance is tipped. The result in the case of an imbalance in government is an "imperial" presidency; in the broadcasting context, the result would be imperial networks.

Two sets of rule changes under discussion would tip the balance of power in favor of the networks.

Cable-broadcast and cable-network cross-ownership. Under current law, a broadcast station cannot own a cable system within its market. The reason behind this law is as valid now as it was when first adopted: Television stations compete with cable *and* depend upon cable carriage for their continuing viability. Replacing a competitive market with one in which cable and broadcast can be owned by the same company will give consumers less choice. Cable companies that own an in-market broadcast station will have substantial incentives to favor their own station through carriage and channel position and undermine their competitors.

National ownership caps. Current rules provide that no licensee can own more than 12 stations or reach more than 25% of the Nation's households. Though the station number rule should be dropped, what should not be fundamentally altered is the cap on national audience reach. Eliminating or relaxing the national multiple-ownership rule would radically skew the balance of power in the network-affiliate relationship toward the network. Networks don't need these rule changes to compete with telephone or cable companies. If the rules are to be changed, the Committee must use an "honest number" that fully attributes ownership interests and does not permit limits to be ignored.

The network-affiliate partnership is unique in its ability to foster diversity, localism, and universal availability. Relaxing the national ownership caps and eliminating the cross-ownership bans is not "deregulation," but a conscious decision to abandon an industry structure based on localism in favor of a structure where a handful of large and powerful networks would exercise concentrated national power in the television marketplace.

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Good morning, Mr. Chairman, and members of the Committee. I am Jim Waterbury, President and General Manager of Station KWWL-TV in Cedar Rapids, Iowa. Today I represent the more than 600 television stations affiliated with the ABC, CBS, and NBC networks. These local broadcasters are small businesses that broadcast local sports, news, political debates, election night coverage, and charity telethons as part of their commitment to their communities.

These television broadcasters asked me to deliver the following message: Your local broadcasters want to remain local broadcasters. The rules defining the relationship between the networks and the affiliates have served our Nation well by promoting localism, diversity, and universal availability of over-the-air broadcasting. Yet the proposals under discussion to abolish the cross-ownership prohibitions or significantly increase the national audience caps would severely damage their ability to continue as local broadcasters.

The damage to local broadcasters would occur because this increased network control would disrupt the delicate balance that exists between affiliates and the networks, a relationship that is similar to one between distinct branches of government. Currently, the networks need their affiliates, and cannot push them too far to broadcast network programming over local programming. Similarly, the affiliates need the networks as a source of national programming. That balanced relationship between the networks benefits both the networks and local broadcasters and, I believe, serves the public. But if too much power is placed in the hands of the networks, just as if too much power is placed in the hands of one branch of government, then the balance is tipped. The result in the case of government would be an "imperial" presidency; in the broadcasting context, the result would be "imperial" networks.

There are two sets of rule changes which we understand are under discussion that would tip the broadcast balance of power in favor of the networks. Let me briefly speak to each of them.

Cable-broadcast and cable/broadcast-network cross-ownership. Under current law, which has been in place since 1970 and was codified in the Communications Act in 1984, a broadcast station cannot own a cable system within its market. The reason behind this law is as valid now as it was when first adopted: Television stations compete with cable *and* depend upon cable carriage for their continuing viability. Though there has been a lot of technological change in the last 10 years, and though we expect tremendous change in the next 10 years, one thing will not change: most broadcasters will depend upon cable systems to carry their signal to the majority of viewers who access their signal through a wire.

Repeal of this law would be anti-competitive. Congress, the Commission and the Department of Justice repeatedly have found that cable operators exercise substantial and growing market power over local stations in virtually every market in the country. Cable companies that own an in-market broadcast station will have substantial incentives to favor their own station through carriage and channel position and undermine their competitors by denying access to cable's essential bottleneck facilities.

Moreover, today -- unlike the conditions in 1984 -- cable systems sell and carry substantial amounts of local advertising. A cable system owned by a local station would (a) have a substantial competitive advantage over non-cable owned stations in the local market in selling advertising, and (b) could disadvantage other local stations by refusing to grant them carriage, or making them pay for retransmission of their signal or denying them access to an additional channel on which competitive news, entertainment and advertising may be provided.

These threats to competition would be even more severe if the cable/broadcast-network cross-ownership prohibition were to be repealed. If the broadcast networks were acquired by the large cable MSO's, they would be free to threaten to by-pass affiliates and place preferable network programming on their own cable channels to force them to accept programming on the networks' terms. Even independent stations competing with a network/cable combination would be threatened because network/cable entities could attempt to deny carriage or otherwise discriminate against these stations. In total, any relaxation or repeal of the cable-broadcast or cable-network cross-ownership rules would undermine localism and diversity.

National ownership caps. The second issue affecting the network-affiliate relationship is the question of how much of the national audience can the networks reach through their owned stations. Current rules provide that no licensee can own more than 12 stations or reach more than 25% of the Nation's households. Clearly, the rule limiting the number of stations serves no purpose, and it should be removed. But what should not be fundamentally altered is the cap on national audience reach by stations under common ownership.

Though the cap currently states that no broadcaster can own stations that reach more than 25% of households, the loopholes currently available enable the networks to exceed that limit. We estimate that CBS will soon have an interest in broadcasters reaching 32% of the country. So as the Committee looks at the question of audience reach, I urge it to use an "honest number" that fully attributes ownership interests and does not permit legal limits to be ignored.

In addition to an "honest number," the affiliates believe that eliminating or relaxing the national multiple-ownership rule would radically skew the balance of power in the network-affiliate relationship toward the network. If networks can own all stations needed to cover the most important markets in the U.S., the affiliate body would no longer be able to preserve affiliates' power to preempt network programming in favor of important local news, public interest and local sports programming. Increased network power also would hamper local broadcasters' ability to compete vigorously in the advertising market. And most importantly, such a change would harm the ability of a local broadcaster to act responsively to their local communities.

And don't be fooled by the suggestion that network-owned stations have expanded local news, and therefore if they can control more of the country through their owned stations, local news will be expanded. First, every broadcaster in the country has expanded its news, so the network-owned stations are not unusual. This also ignores the point that a network-owned station almost never preempts a network program to cover a local sports game or do a local charity. But more to the point: If the networks had the power, which they don't now, to make the national feed of news one hour long, they would do so -- at the expense of local news. It would only make economic sense for them. The only reason network-owned stations expand local news is because they don't have the ability to do it at the network level for all stations in the country. But don't kid yourself -- if they had the power, they'd do it in a New York minute.

Now I know that some people here in Washington are arguing that rules in place will protect affiliates in their dealings with the networks. Well, that may sound appealing to government lawyers in Washington, but let me tell you the experience of a broadcaster operating a station in Iowa. I face regular struggles with the networks on preempting network programming for local coverage, whether it is a local sports event or a charitable fundraiser. The idea that there may be

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some rules somewhere in Washington provide little comfort when you have to go head-to-head with the network organization.

Also, the Committee should realize that networks don't need these rule changes to compete with telephone or cable companies. Networks are programmers, and local affiliates supported changes in the FCC's rules -- including the financial interest and syndication rules -- to make the networks more competitive as programmers.

The local broadcast industry will succeed in the future if you do not destroy it by eliminating the existing strong, balanced network-affiliate partnership. The only reason a network wants to dominate and control all of its outlets is if it seeks to control all programming from New York or, if the head of NBC is correctly quoted in a recent New Yorker magazine article, move all network programming towards a pay-per-view service. The broadcast networks have every economic incentive to move their best programs to a pay-per-view delivery system. Neither outcome serves the public interest.

There is one final point that I need to address: Those who must justify a bare grab of power are attempting to wrap themselves in the mantle of "deregulation." These proposals are sold as "deregulatory" when, it fact, they would concentrate power in the hands of the networks and, in the end, be anti-competitive. My friend here from the Fox Network will admit that it would have been next to impossible for his network to get on the air if the national and local owernship rules he is attacking now had been abolished ten years ago.

The Fox Network has been good for affiliates and good for the public, but let's not destroy the chance for another Fox being set loose.

In short, the ownership rules were put into place to facilitate the development of a competitive television broadcast service, owned by multiple companies, that provide a wide range and diversity in programming judgments and decisions. A repeal of these rules by Congress would be a giant leap backwards.

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The network-affiliate partnership is unique in its ability to foster the core values of diversity, localism, and universal availability of free over-the-air service. Affiliates can continue to serve these values only if the basic structure of the network-affiliate relationship is preserved. We agree that Congress should streamline the FCC's regulations when appropriate, but must maintain these rules that are essential to localism and diversity. Relaxing the national ownership caps and eliminating the ban on broadcast-cable and cable/broadcast-network cross-ownership is not "deregulation," but a conscious decision to abandon an industry structure based on localism in favor of a structure where a handful of large and powerful networks would exercise concentrated national power in the television marketplace.

In short, if a few large companies can own enough television stations to reach more than 25% of the national audience, without negotiating with others for the exhibition of their programs, the delicate local-national partnership that has been the strength of our system of broadcasting will be destroyed. The goals of diversity and localism, long the pillars of the Communications Act of 1934 and the broadcast industry, would be obliterated with the stroke of a pen.

Finally, the cost to the federal government and the industry of enforcing these structural rules is minuscule. Compare what it would cost the government and the affected industries, if these matters were handled on a case-by-case basis in antitrust actions filed in hundreds of local federal courts across the country. A repeal of these rules, with their simplicity and efficiency of administration, would be counter-productive to the commitment of this Committee to reduce waste and efficiency in government.

The CHAIRMAN. Thank you very much.

Mr Ellis, you mentioned in your testimony that relaxing the local ownership rules will result in more diversity and competition. People who disagree with relaxing the local ownership rules say it will have just the opposite effect. How do you know it is going to result in more diversity and competition?

Mr. ELLIS. Well, for a television station, in order to compete against the other television stations and/or the other video providers in a marketplace, a television station must have the economic viability in order to invest in the local news and public service programming. There is no future for the local television station to be simply an on-air redistributor of satellite-delivered programming. There are too many other more efficient ways to do that. And there is no magic dust in the economics of this industry. All we have is advertising to fund the investment in these services.

By virtue of duopoly and/or LMA's, two television stations can share some of the duplicative costs of operation in order to invest in that programing that is going to be more viable locally, and of more interest to the local consumer. And in a duopoly or in an LMA situation it is in the best interests of the programmers of those stations to make them more diverse, not complete duplicates of each other. That serves no purpose.

The CHAIRMAN. I know that ownership caps are an issue on which the broadcasting industry could not reach agreement, as I understand it. Frankly, I am troubled by the prospect of an industry like the NAB Board sitting around the room trying to reach agreement on how big any one player should be allowed to get. Now, that is anticompetitive. I guess that Speaker Gingrich said in yesterday's Broadcasting Magazine if you had caps in software you would not have had Microsoft. But would any of you like to comment on the general issue of ownership caps?

Mr. PADDEN. Sure, I would be happy to respond to that. I sat through the deliberations of the NAB television board trying to come to an agreement on an agreed-upon limit so that we could have sort of gentlemanly competition and nobody would get hurt too badly, and I was struck that it was an entirely inappropriate process. We had people stand up and say look, I am trying to buy stations, and if these other guys over here can all be in there bidding against me I will have to pay more to buy those stations. And I thought to myself, yeah, that is kind of the way the marketplace is supposed to work.

So I think you would be well-advised to be weary anytime an industry group came to you and said we have all agreed on exactly how much we are going to compete with each other. I also found myself thinking in that room that if those folks had had a chance to vote 10 years ago they would have almost certainly voted not to allow a fourth network to happen.

Mr. WATERBURY. Senator, that might have happened 10 years ago. I do not believe that would happen today. We are very competitive. We compete with cable companies all the time; we are used to an ever-expanding number of channels available on cable systems as well as over the air; but insofar as this issue of caps is concerned, I think it is a question of influence and control. With the cap at 25 percent right now, the question is not one of moving from 25 percent to 100 percent, the question is moving from 25 to 51 percent.

Because at 51 percent the other 49 percent of any network would in fact be disenfranchised. You would find an enormous number of stations, if any network were allowed to move to a 50 percent cap or a 51 percent cap, an enormous number of stations who would simply have no further voice with their network because the network could simply say we have the majority of affiliates with us and we are going to do this and such. So I think it is an issue of balance and control.

The **CHAIRMAN**. I would address this to Mr. Fritts, and to all: Does not the FCC already have in place a series of rules, regulations, and restrictions governing the network and affiliate relationships which at bottom seem to be Mr. Waterbury's concern, I believe? Are not these rules especially relevant to this ownership debate; most significantly, the right-to-reject rule which states that a network my not prevent or hinder an affiliate from rejecting network programming or substituting non-network programs?

Mr. **FRITTS**. Mr. Chairman, I understand the question. If I might, I would like to add onto what was a followup to the last question inasmuch as President of the Association I do not want to leave the impression, particularly before the Congress and the United States public that we sit around and carve up competition at the NAB Board of Directors. It is a very diverse board of directors. The question laid on the table before them was do you want to change the FCC ownership rules, and it was prompted by a discussion draft that came from this committee. So we were responding to a legislative proposal that was on the table and it was not—and I have never heard, and we have legal counsel in all of those meetings to make sure we do not overstep the bounds on antitrust.

Yes indeed, there are rules at the FCC, but since we are neutral as an industry I think I will let my three colleagues respond to that.

Mr. **WATERBURY**. Mr. Chairman, I will step in, if I might. The right-to-reject rule basically protects stations from unwanted intrusion on program schedules by networks, and gives us the right to reject programming that is, quote, unsatisfactory, unsuitable, or contrary to the public interest, and instead requires us and allows us to substitute programming of greater local or national importance. But the fact of the matter is that the networks, particularly in light of the past year's activity and churn in this industry, have all entered into long-term agreements with a substantial number of their affiliates, and several of the networks in particular have included language or have attempted to include language in their agreements with many of the affiliates that is much more restrictive than that.

One of the networks, for example, limits these kind of preemptions to fast-breaking news events. I would submit to you that that might, in fact, eliminate a local station from doing extensive local coverage of the O.J. Simpson trial.

Unless something particularly relevant is happening on a day, that would not be a fast-breaking news event. Another network asks affiliates to agree in a 7-to 10-year contract stipulation that we do not foresee the need to preempt other programming other than as specified in this agreement. That is a far cry from what is envisioned by the right to reject rule.

The programming that the networks deem unsatisfactory under this particular contract means only those programs that are technically inferior—that is, not airable technically—legally impermissible, or programs that are not in good taste. And what the network defines in good taste is programs that we have not previously sent to you. In other words, if you have accepted a cop show before, you automatically will clear the next cop show that we make because we take it that you consider that in good taste.

Again, we think these are onerous restrictions that were not in place a year ago, and while that rule is there right now, it may not be there for long.

Mr. ELLIS. Mr. Chairman?

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. Go ahead, Mr. Ellis.

Mr. ELLIS. Our group does not view the networks as our competition. We have gives and takes with our network relationships like any other franchise-franchisor relationship, but the competition that we are the most concerned about are the multichannel providers, and these are the cable companies, the telephone companies, and the other entities that are going to be in our marketplaces with multichannel offerings. In that regard, we think the most important thing to be addressing is the ability of the local broadcaster to have the economic viability to continue to offer strong local programming, and we believe that is going to require a multichannel environment for them, as well.

Senator HOLLINGS. But with respect to the ownership by the network of affiliates, what is your position on that, Mr. Ellis?

Mr. ELLIS. Personally, I have no objection to increase of the caps of the networks. I am in favor of total deregulation. On behalf of the group that I speak for, we are generally in favor of deregulation of the networks and broadcast in the national ownership caps.

Senator HOLLINGS. Well, I must say that I am more impressed with the concern that Mr. Waterbury expresses with these individual stations. There is no question that the networks can own 12, they can permeate 25 percent of the market in that area, and they have got enough control now. And I agree with Mr. Waterbury, if they get to that 51 percent I can tell you, you can forget about the public interest at the local level. We have already done away with the fairness doctrine, you are moving every day away from entities that come in like cable and others with no regard for the public interest, and the core excellence of the public broadcasts in the United States has been those local affiliates who have done a wonderful service and they now are beleaguered by all kinds of competition, innovations, and everything else of that kind, now, to just take the network and say you can eliminate that local flavor, that local public interest, by mandating from New York, I think would be a bad, bad move for broadcast entities here in the United States.

We already see too much TV violence. We get every kind of hearing that we have had and we get all the representations from the networks themselves that they are going to clean it up, clean it up, and then their own magazine, Broadcast Magazine, says it is on the increase, increase, increase. So we know, Mr. Ellis, about those economic considerations and that dollar controlling. I would rather have the tendency toward the local public interest rather than the economic concern cared for in this particular regard. That is why we provided the flexibility to the FCC but not the outright repeal of 310(b)(4). I think that would be a tragic thing for the networks to be able to come in and own them all, or 51 percent, as Mr. Waterbury said.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Ellis, I want to make sure that I understand. You would like the right, and I do not mean this critically, to go into a town and perhaps own two stations.

Mr. ELLIS. Correct.

Senator PACKWOOD. You are not carrying the water one way or the other for the networks on that answer. This is just you, as an entrepreneur.

Mr. ELLIS. That is correct.

Senator PACKWOOD. Mr. Waterbury, do you have any objection to that?

Mr. WATERBURY. Senator, our group does not speak directly to that issue. There are some members of our group that would agree with Mr. Ellis. I think it is once again a question of voice in the marketplace, and it troubles me to come to you to ask for duopoly on the one hand and on the other hand to ask you to keep the caps in place on the networks. So my response to you, sir, would be yes, I disagree with Mr. Ellis on that.

Senator PACKWOOD. In terms of bargaining with the networks, would the affiliates not be stronger if Mr. Ellis owned 20 or 25 stations, there might be a couple in one town, but he is not a network, he is an entrepreneur now bargaining with the networks?

Mr. WATERBURY. He might have some additional leverage inside the industry, but as far as with the networks themselves I think not, because you would be simply paring down once again the affiliate voice. Instead of being 100 percent NBC in a market he might be 50 NBC, 50 percent something else, which means that the networks can pay half as much attention them as they did prior to making that split.

Senator PACKWOOD. Well, let me ask Mr. Ellis. Let us say, Mr. Ellis, you owned 25 stations, two are in five markets. Would you be in a stronger bargaining position to go to NBC and say I do not like the contract you want me to sign and I think I am going to sign with ABC?

Mr. ELLIS. Yes, I think it would put us in a stronger position, but I think that is not the relevant issue. We are not competing with our networks. That is not who I view.

Senator PACKWOOD. No, I know. I know that is not your—it is Mr. Waterbury's concern about the power of the networks, if I understand it correctly.

Mr. WATERBURY. Yes.

Senator PACKWOOD. And I know that is not your concern.

Would it make you stronger vis-a-vis the networks if you owned 25 or 30 stations, some of which might be two in one market?

Mr. ELLIS. Absolutely.

Senator PACKWOOD. Would the network pay a lot more attention to you?

Mr. ELLIS. In a consolidating industry, a consolidated position will give you more strength.

Senator PACKWOOD. Now, let me ask Mr. Fritts a question in your neutral nonpartisan bipartisan no-opinion position. [Laughter.]

Senator PACKWOOD. I am an owner of a television station in Eugene, Oregon. From a standpoint of the value of that station if I want to sell it, am I better off that both the network and Mr. Ellis could bid on it?

Mr. FRITTS. From a personal point of view, absolutely. The more buyers there are for a product, the better the price will be.

Senator PACKWOOD. In that case—now, put on your ability to argue both sides of this issue had—why would local affiliate owners be opposed to letting the networks own more stations, assuming Mr. Ellis can bid also, and it would increase the value of their property?

Mr. FRITTS. I know you were going to do this. You put me in a difficult spot. I think that is a question for Waterbury or for Mr. Padden, quite frankly, because they are affiliate broadcasters and have a better feel for that.

Senator PACKWOOD. All right. Mr. Waterbury, go ahead first.

Mr. WATERBURY. Thank you, Senator. Obviously, nobody would object to having a property value increase, but the people that we represent by and large are operators. We are not interested in being in the business for a quick turn, we are interested in being in the business for many years of service. Many of our members, in fact, are second-generation owners; a substantial number are not. But the fact is that we are local businesses with long ties to local communities and we want to stay in business.

Senator PACKWOOD. I understand that. I like local broadcasters. I like the diversity. I have never seen a business yet that was not for sale at a right price. I do not know where that margin is, and maybe there are one or two left that would say I do not care how much Fox offers to buy me or NBC, I do not care if it is five times what this station is worth, I like the business I am in. There may be a few like that, but I do not think there are a lot.

Mr. Padden?

Mr. PADDEN. Well, I was going to respond first by assuring Mr. Fritts I did not mean to suggest, Eddie, that we were violating the law in the board meeting. I know that those discussions are discovered by the Moore-Pennington Doctrine and we were well within that. I was speaking to the extent to which those kind of recommendations ought to carry weight up here.

But on the issue of the public interest, if networks buy more stations I think it is instructive that the network-owned stations in fact present the largest amounts of local news and public affairs in their communities of any stations in the industry. In fact, the stations owned by the networks just happen to present more local news, generally speaking, on their stations than do the stations owned by Mr. Waterbury's group. So if your concern is the level of local public affairs and news programming, the objective facts would cause you to want the networks and the large groups to own as many stations as possible because they, in fact, do the best job of presenting local news in their communities.

Senator PACKWOOD. What do you say to that, Mr. Waterbury?

Mr. WATERBURY. I would agree with Mr. Padden that the network stations by and large present more local news than smaller stations. They have more resources to do that. I would also say that much of that news product is simply repackaged over a period of several hours. I think the larger issue is one of if the networks get too much control of the network system—of the affiliate system, you would find that more network news would find its way into local channels, crowding out local news.

Senator PACKWOOD. I thought local news was a good moneymaker for stations. Mr. Ellis?

Mr. ELLIS. Yes, sir. It can be. And in most of our stations it is the single largest producer of revenue on the station. And it is a very important franchise. It is very expensive to get in if you are not already there, cost prohibitive, in many cases.

Senator PACKWOOD. But you would have no desire to put on more national network news and cut back your local news?

Mr. ELLIS. Right. On point, we are ambivalent as to who owns the television stations in a market, so long as they program them as local broadcasters. That is the only future of the over-the-air system, is a lot of local broadcasters.

It is not a national over-the-air broadcast system, it is a large number of local over-the-air broadcast systems, and it is absolutely counterproductive and it is bad business for anyone, whether it is a group owner or a network or small group owner, to dictate the local programming of a market from afar. It is just not done. It is not done by anybody at this table. I do not believe it is done by any group that I know of. If it is, it is bad business.

Senator PACKWOOD. That is my intuitive experience. I go to towns that have not only affiliates but owned and operated, and they seem to do a tremendous amount of good local news, to the extent you define the kind of news that anybody does as good.

Mr. ELLIS. The best thing you can do as a local broadcaster is put the best people you can in place, and give them the mandate to serve their local marketplace and make sure they have the economic viability to invest in that local news, that local public service programing, local sports, whatever you can do to be a local station. That is the only way to differentiate the free over-the-air broadcast system from the nationally delivered satellite and/or wired services that are much more efficient to deliver. A local broadcast station is very inefficient if all you are going to do is retransmit national programming. It will not survive as a retransmitter.

Mr. PADDEN. In fact, Senator Packwood, you are exactly right, local news is very profitable, and at Fox part of our counter-programming strategies, one of the benefits of competition, is we have found we can succeed by presenting local news programming when the other stations in town are presenting network programming. You have the example right here in Washington with the Fox Morning News in the morning, a locally based show up against the three network shows. We are attracting a lot of audience, making a lot of money, we come back in prime time when they are running Murder, She Wrote and we put on a local news at 10 and make a lot of money, and in fact, in the arguments we make to affiliates of the three old networks to switch to Fox, one of the strongest arguments we make, is if you come with us, drop your old network, we will free you up to present local news in time periods where your local competition is stuck running networks shows, and you will be able to make more money just like we do at our stations.

Senator **Packwood**. I frankly am intrigued by the success of the 10 News of an independent station in Oregon. The others are not on until 11, and they do very, very well, with that programming.

Mr. **Waterbury**. Senator, I do not disagree with anything the other gentleman has said, but I wish our networks were similarly enlightened. If they were, perhaps we would not be looking at new——

Senator **Packwood**. Maybe you and I ought to talk after the hearing. [Laughter.]

Mr. **Waterbury**. Perhaps we would have an opportunity to be dealing with them on contract bases that are not so restrictive as what we see now, but clearly they do not support the idea of localism, because they in fact are trying to tie us more closely to them, and I would also disagree with one point, if I could contradict myself on just this one point.

Mr. Ellis is right that the future of broadcasting is local, but we are a system of local and national service, and we need the networks, and they need us. The point is, we do not want to become their company stores.

Senator **Packwood**. Thank you, Mr. Chairman. I might say to Eddie, this is the first time I have heard you sound like Buddha. [Laughter.]

The **Chairman**. Senator Breaux.

Senator **Breaux**. Thank you very much, Mr. Chairman.

Mr. **Fritts**. I think Senator Packwood is really on today. First he jabbed Roy Neal and he got me good, too.

Senator **Breaux**. Mr. Waterbury, let me ask a question. You base some complaints about your relations with NBC and some of the things that the network tried to get affiliates to do that you may not think it is in your best interests. Why would you not then want to have the option of just telling them goodbye, I am going to go sell my station to Padden for some outrageous profit?

I mean, isn't one of the reasons that you have problems sometimes with networks is because they know you are locked into them, and that you do not have the option to market your local, affiliated station to somebody else?

Mr. **Waterbury**. Yes, Senator, that is correct, we do not have that many options, particularly in the smaller markets, those under, say, markets 50. There are 211 television markets in the country, and as the previous panel alluded to, most of the money is in the top 50. Actually, most of the money is in the top 25.

Senator **Breaux**. So that is the point I am trying to make is, if an affiliate has problems with a network who is leaning on them to do things that they may not think is in their interest, the chairman's proposition of removing the camp should be in your interest. It gives you other options to sell your product, and you have the option to say, look, if you do not treat me right, I am out of here because I have some options, and one of my options is to sell to

Fox, or to sell to somebody else that may want to penetrate this market at a better price, and with less restrictions. Isn't that a good thing to do?

Mr. **WATERBURY**. Only if one network is standing away from the other networks in the number of restrictions that it seeks to place on affiliates. My experience is that all the networks are moving rather sequentially toward more restrictive contracts.

Senator **BREAUX**. If you have problems with one, is it not better for you to have options to go to somebody else?

Mr. **WATERBURY**. Yes, sir.

Senator **BREAUX**. Let me ask Mr. Fritts, and I know,

Eddie, you have not taken a position, but I am trying to figure out, of the limitations on ownership of the networks you have got a 12-station Nationwide limitation, and you have the 25-percent audience cap. Of the two, which one is the most onerous as far as ownership is concerned? Is it the 12-station limitation, or the penetration of the audience cap?

In other words, I am trying to figure out if we have to make a decision to address the audience cap, or to address a number of stations and maybe just do one instead of both.

Which would be the better way of pursuing this?

Mr. **FRITTS**. You know, I feel ill at ease not being able to respond directly to your questions, because that is not my style, but in this case, quite frankly—I think, quite frankly, there are two sides to that coin. I think some of the people at this table would be more interested in increasing the numerical cap and others would be more interested in increasing the percentage cap.

Senator **BREAUX**. Let me ask that. Mr. Padden, do you have a comment on that?

Mr. **PADDEN**. It depends on the size markets in which you purchase stations. For all of the networks and several other large groups like the Tribune Company, we are bumping right up against the 25 percent right now.

If, on the other hand, you were buying a lot of stations in smaller markets, you could probably get to 12 easily without bumping into the 25, so the two really do work together, and I come back sort of to our central point, which is we think all of these regulations are left over from an era in this business that bears no relationship at all to what is happening out there today, and we think they deserve a zero-based review, and we think you will conclude they ought to be repealed in their entirety.

Senator **BREAUX**. Mr. Ellis, do you want to comment on that?

Mr. **ELLIS**. Our group has no objection to an increase of the actual numeric ownership cap, and we have some concerns about the relaxation of the percentage cap but are willing to live with some.

Again, our biggest concern, though, is that whatever relaxation of the rules, whether they apply to telephone, cable, or broadcast regulation, bear in mind the local broadcaster, and that is the most important part of the broadcast system, the free over-the-air broadcast system, to permit us to be multichannel competitors in a multichannel environment, the big competition, the guy that is going to have all the power in our local marketplace is going to be the sole owner of the one cable system that serves the entire market, and/or, even worse, the sole owner of the one joint venture telephone-cable system that is going to serve the entire market.

That entity is going to be able to compete head-to-head for all of our advertising dollars and will be able to subsidize their entry into our most profitable venture, news, with significant dollars from other revenue bases that we will never have access to, and to be able to come and cut the life blood and the knees right out from under the local broadcast station. That is what we need to protect. That is what we want to compete to protect.

The CHAIRMAN. What about the argument that some of the affiliates make, and I guess Mr. Waterbury may share this thought, that by repealing the cap, I mean, you are just putting too much power in the hands of the networks?

Mr. ELLIS. The networks do not dictate how we program our television stations. My company has or will have affiliates of all four of the existing networks—none of the two wannabes, but of the four existing networks—and again, we have negotiations on a number of things, but they do not dictate how we program our local television station.

I have the ability to run my company, and I do not dictate how my local television stations program the local television stations. It just is not good business to do so. I cannot tell you on a day-to-day basis, sitting in Atlanta, my headquarters, what is good for my constituents in Memphis, or what is good for our consumers or advertisers in our other markets. I have to leave that to the people on the spot.

Senator BREAUX. Is, in fact, your ability to consider selling one of your affiliates to another network, does that not increase your negotiating strength with the network you happen to be with?

Mr. ELLIS. I do not believe that plays into the negotiations. As an acquisitive company, we are trying to acquire additional properties so we can build critical mass and participate in the television system of the future. We compete with various players for the acquisition of television stations. Some are other groups, some are other individuals, in some cases they may be networks, and that is OK by us.

We want to have critical mass to be able to invest in local news, public service programming in our local markets. That is what we are looking for, and a multichannel environment necessitates multichannel competition. Otherwise, you are going to eventually have your revenue base eroded out from under you with no ability to protect your flank.

Senator BREAUX. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Burns.

Senator BURNS. Let us shift gears here, and I am sorry I missed your testimony. I have too many things to do and no time to do it.

Let us talk about radio just a little bit, Mr. Fritts. That is kind of what I am most familiar with, anyway. This bill allows deregulation of ownership rules for radio broadcasters. Do you believe that this is necessary?

Mr. FRITTS. Absolutely, Senator. You talked about the NAB board, and there are some smattering of people who are making noise about this. There are 18 board members on the radio board of NAB who operate in markets of less than 25,000. Seventeen (17) of those 18 board members voted to eliminate the radio ownership rules.

The reason that they should be eliminated is that we have an overpopulation of radio stations. The FCC through docket 80–90 imposed 2,000 new FM stations on the marketplace, so smaller market stations in particular have been hurt by this, and the FCC loosening of the rules did not help those smaller market stations, because they do not allow duopolies or concentration to take place in smaller markets, and as a result, those stations are still suffering, whereas in larger markets we have had some consolidation, and it has been somewhat helpful for the larger market stations, but we are still waiting for relaxation in the smaller markets for the radio stations.

I mentioned earlier that even if one entity owned 100 radio stations, they would still only have less than 1 percent of the total amount of radio stations.

The other reason I think it is critically important is that the FCC is about to unleash satellite DAB, 60 channels of digital audio quality broadcast for radio coming from 22,300 miles in the sky, with no local service requirements, no local news requirements, no local weather, no school closings, but yet 60 new channels of radio owned by, ostensibly, one entity.

Now, if you are going to allow one entity to own 60 stations in one market, or virtually across the country, then the rationale to hold one to a market, even down to the tiniest market, just does not hold water.

So I think the fact that if the Congress would be concerned about concentration of control, there are antitrust laws which we would submit would suffice in the local marketplace, so we believe, and our board believes, and I believe the industry believes that relaxation of ownership rules for radio is not only necessary, but it is long overdue.

Senator BURNS. Mr. Fritts, I guess that leads me to—you talk about NAB—to the next question. What do you think this does? In other words, if the regulation is just taken clear off, what does that do to localism?

In other words, are we going to lose our local flavor for our broadcast, for our radio broadcast people?

Mr. FRITTS. If we were to do away with local radio rules, what would that do to localism?

Senator BURNS. Yes. You see, I am concerned about communities.

Mr. FRITTS. Of course you are, and all of us are. I think that would enhance local service, because right now, in, let us say, a middle-sized market, you have eight radio stations competing against one another, all scrambling for the same advertising pie, all having to reduce cost in order to make ends meet.

If those stations can consolidate to some degree, you can have economies of scale, you could have the same sales department, you could have the same engineering department, the same administrative department, you could share news people ostensibly. You can provide additional local service, whereas right now, those stations are withering on the vine in many cases under having to, quite frankly, reduce local service, and that is very unfortunate.

Mr. ELLIS. Senator, might I add, you could substitute video for audio in Mr. Fritts' entire remarks, and the same economics apply.

Senator BURNS. I was going to come up with the questions that—Mr. Waterbury, you manage a station in Waterloo, Iowa, and yet you are owned by a group that comes out of what,

Atlanta, Georgia?

Mr. WATERBURY. Columbus, Georgia, sir.

Senator BURNS. But anyway, what effect do the decisions made in Georgia have on you making your decisions for Waterloo, Iowa?

Mr. WATERBURY. I speak with my boss in Columbus several times a week, but the decisions are made by me at the local level. There are seven stations in my broadcast group, and like Mr. Ellis, those decisions are made at the local level now. I make some of them, and I have managers for two stations that I oversee that make them in Baton Rouge and Huntsville, Alabama as well.

Senator BURNS. I think that is all I have, Mr. Chairman.

The CHAIRMAN. Thank you. I want to thank this panel very much.

Senator BURNS. I have their testimony. I missed your comments, but thank you very much.

The CHAIRMAN. While you were away, a very fine letter to you was read, but Mr. Padden will tell you about that later.

We will move the next panel up very quickly and in an orderly way here. This panel is on foreign ownership.

Mr. Scott Harris, Bureau Chief, International Bureau, Federal Communications Commission, and Mr. Eli Noam, director,

Columbia Institute for Tele-Information, Columbia University.

We will call on Mr. Harris first for his statement, and we thank you very, very much.

STATEMENT OF SCOTT BLAKE HARRIS, BUREAU CHIEF, INTERNATIONAL BUREAU, FEDERAL COMMUNICATIONS COMMISSION

Mr. HARRIS. Chairman Pressler, Senator Hollings, and Senator Burns, it is a privilege to be here this morning to discuss with you the issue of foreign ownership in the U.S. communications markets. I would like to begin by saying that as soon as I return to the FCC, I will talk to our interference specialists and have them contact your staff and see if we can resolve the problem we had here this morning.

To ensure that I have a job when I return to my office, I also want to begin by noting that I am testifying to my personal views and not those of the commission. With that caveat, let me say that I believe the time is right for legislative action to revise section 310 of the Communications Act. Such an action by this Congress would send a clear and powerful message around the world about our continuing commitment to competition.

Why should we revise 310? Because today it is an impediment to U.S. industry overseas and to global competition. But, if revised, section 310 could help create competitive opportunities for U.S. industry abroad by creating enormous incentives for foreign Governments to treat U.S. industry fairly.

The world stands on the brink of an enormous change in its telecommunications markets. The monopoly is dying. It has been killed by the intellectual power and by the demonstrated success of competition in the United States. Yet as the world moves to competition slowly, and sometimes fitfully, it is not yet clear whether U.S. industry will be allowed to participate in that competition.

Section 310 is a problem, because it provides much of the world with a plausible excuse to exclude U.S. industry. The U.S. limits access to its markets, they say. Surely we ought to do the same. Just last Thursday, the European Parliament passed a draft directive permitting companies with a single national license to provide service in all of the countries of the European Union. They excluded companies that had more than 25 percent foreign ownership. Reuters described that as "a slap at the U.S." This is the problem with 310 as it is currently configured. So why not eliminate it? Even with 310, our communications markets are far more open than most communications markets around the world. To be honest, I am not convinced that if we simply eliminated 310, foreign Governments would treat U.S. industry fairly, though certainly it would be in their best interests to do so.

Moreover, even today, there may be an occasional case where there are national security and other policy reasons to keep 310 in place. But we can use 310. We can use 310 to create a powerful incentive for foreign Governments to give U.S. industry a fair chance to compete by weaving into it, as part of the public interest analysis, the issue of whether the foreign Government provides U.S. industry with an equivalent opportunity to compete. And as foreign markets opened, so, too, would the U.S. market, creating more competition here, giving consumers still greater services and still lower prices.

Having handled a few 310(b) cases, I hope it is appropriate for me to offer several suggestions about how you might revise section 310. First, let me say there are two things I would suggest not changing.

First, I would retain the public interest test as the touchstone of whether an investment in excess of 310 limits ought to be granted. Second, I would retain the general ban on license ownership by foreign Governments.

There are, however, four changes you might wish to consider. First, you might wish to consider eliminating the current distinction between direct investment in a licensee which is limited to 20 percent with no possibility of a waiver, and investment in a holding company which owns a licensee which is limited to 25 percent, but with the possibility of a waiver in the public interest. I would simply suggest you consider selecting a single numerical standard and applying it in both instances. Second, you might consider including in the public interest test consideration of competitive opportunities available to U.S. industry in the primary markets of a 310 applicant here.

Third, you might consider permitting the FCC sufficient flexibility to take into account new developments in foreign regulatory regimes, and to give the FCC flexibility to grant applications in part, or to condition those applications as is appropriate.

And finally, you might consider a minor modification of the ban on foreign Governments holding licenses so as to exempt satellite news-gathering, unless the Government in question denies similar access to U.S. media.

I thank you for taking the time to listen to me, and I will do my best to answer any questions you have. Thank you.

[The prepared statement of Mr. Harris follows:]

TESTIMONY OF SCOTT BLAKE HARRIS
CHIEF OF THE INTERNATIONAL BUREAU
FEDERAL COMMUNICATIONS COMMISSION

ON

FOREIGN OWNERSHIP RESTRICTIONS

BEFORE THE COMMITTEE ON COMMERCE, SCIENCE
AND TRANSPORTATION
U.S. SENATE

MARCH 21, 1995

Introduction

Mr. Chairman and Members of the Committee

It gives me great pleasure to appear before you today. This is my first opportunity to appear before you and I am pleased that you have asked me to testify on a topic of such significance to the future of the U.S. communications industry -- restrictions on foreign entry in the U.S. communications market. The resolution of this issue will have a great impact not only on the competitive opportunities for U.S. industry in the United States, but also in foreign markets. Your draft proposal, Chairman Pressler, is particularly significant because it focuses the debate on this critical issue. You and your colleagues will have a decisive impact on the shape of the global communications market. I believe that legislative action in this area is essential, and the sooner the better. I also believe a revised Section 310 can help further the public interest in ensuring that U.S. companies have increased competitive opportunities in communications markets overseas. Let me also say for the record that the views I am about to express are my own personal views and are not intended to represent those of the Federal Communications Commission.

I. Global Services Market

The question of foreign ownership restrictions is at the top of the agenda internationally as well. Recently, the G-7 countries' Ministers of telecommunications convened in Brussels to discuss the development of the global information infrastructure. This is the first time the G-7 has ever focused on one single industry, which demonstrates the pivotal role the communications industry plays in the world economy. I believe that it is important to the domestic debate on the future of the foreign ownership restrictions to

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consider international developments, such as the G-7 countries' agreement on key principles -- including notably private investment and competition -- introduced previously and reiterated in Brussels by the Vice President.

The communications industry is undergoing a profound transformation. Communications providers and users are developing a global perspective. We are seeing U.S. and foreign communications companies developing new strategies to serve their customers' needs -- including international alliances and individual entry into foreign markets. There is no question that U.S. service providers are responding to an increasing consumer demand for novel solutions to global telecommunications needs.

A competitive global services market offers significant benefits for U.S. consumers and the U.S. economy. U.S. companies will become successful global competitors. U.S. consumers will enjoy reduced rates, increased quality, and more innovative communications services.

But a competitive global services market is not possible if foreign countries do not allow U.S. companies opportunities to compete in the most basic telecommunications services. While foreign investment can enhance the competitiveness of our own markets, our companies must have equivalent opportunities to compete effectively in the foreign investors' home countries. Completely unrestricted entry into the U.S. market by entities from closed foreign countries will do more to inhibit international competition than enhance it.

These competitive concerns recently lead the FCC to initiate a comprehensive rulemaking proceeding addressing foreign entry into the U.S. market under Sections 214 and 310(b)(4) of the Communications Act of 1934. The Commission's goal is to determine the best way to regulate foreign access to the U.S. communications market in order to promote global competition. The key to the Commission's rulemaking is a proposal that, when considering foreign requests to enter the U.S. market, the Commission explicitly consider whether the primary market(s) of the foreign applicant offers U.S. industry effective market access.

The Commission's rulemaking is a step in the right direction. However, as Chairman Hundt recently stated before the House Commerce Committee, legislation to accomplish these goals would serve U.S. industry and consumers even better. It would send a clearer, more powerful, more permanent message to the rest of the world. Vice President Gore challenged other countries to join the United States in dropping barriers to foreign investment for those countries who do the same. With your draft proposal, Chairman Pressler, you have done the same thing.

II. The Current Section 310 Hampers Effective Global Competition

In my role as Chief of the International Bureau, I am repeatedly told by U.S. service providers that Section 310 currently impedes their efforts to gain competitive opportunities in overseas markets. Modification of Section 310 can, however, produce an effective tool to achieve opportunities for U.S. entities in markets abroad and introduce additional competition into the U. S. communications market. It can do so by creating significant incentives for foreign governments to open their markets to U.S. industry -- bringing more growth and jobs to the U.S. economy. The incentive would be to allow more competitors into the U.S. market as markets open overseas -- bringing even lower prices and better services to U.S. consumers and businesses. This way the United States would win twice: (1) more revenue for U.S. industry and jobs for Americans, and (2) better services and lower prices for U.S. consumers.

Foreign governments, rightly or wrongly, view the current Section 310 as closing the U.S. market to their companies. Section 310 has become a metaphor for a closed U.S. market. It has become an excuse to go slowly on embracing competition and opening foreign markets to U.S. competitors. At international gatherings or bilateral discussions, the United States is routinely criticized for Section 310.

The European Union, for example, has recently argued that, since most U.S. carriers use some form of radio facility to supplement their wireline telecommunications facilities, any foreign equity investment will be subject to the restrictions of Section 310. The European Union, therefore, views the U.S. communications market as essentially closed. While this dramatically overstates the truth, it does not overstate the problem. In today's global environment, Section 310 may unnecessarily impede U.S. companies' ability to attract investment, and thus develop their own global strategies.

This negative perception of the current Section 310 detracts from the U.S. Government's efforts to demonstrate the openness of the U.S. market and to advance the goal of global liberalization. It hinders the efforts of U.S. companies to compete in foreign markets. Indeed, as I have observed, certain foreign governments have incorporated, or are proposing to incorporate, parallel investment limitations in their own regulatory frameworks.

Why not, then, simply eliminate Section 310? For all the criticism of the United States, foreign markets typically are much more closed to competition than our own. In

Europe, basic local, domestic long distance, and international switched voice services generally are provided by monopolies. Likewise, most European Union (EU) member states impose significant restrictions on foreign investment. Wireless services generally are subject to limited competition and foreign participation is often restricted. In the E.U., there are a few notable exceptions to this rule. In other regions, most markets are also closed to competition, though again, there are important exceptions in each region.

Let me reiterate that I believe it is in the public interest for U.S. companies to have increased competitive opportunities in communications markets overseas and that a revised Section 310 can further this goal.

Now is the time to act. U.S. communications companies are the most successful in the world. Just a couple of weeks ago, the International Telecommunications Union released a report which listed the top 25 information-communications companies among the G-7 nations. 12 of the 25 ranked companies were U.S. companies. Results like this explain why the U.S. vision of competition is gaining ground around the world. But it is not yet clear that U.S. companies will be given a full and fair opportunity to participate in that competition. There cannot be real competition if the best competitors -- U.S. competitors -- are excluded.

III. Comments on Section 310

The International Bureau's experience in handling applications which raise Section 310(b) issues lends me to make the following observations on how Section 310(b) could be more effectively restructured. Let me begin by noting that two important elements of Section 310 should not change. First, I submit that Congress should retain the "public interest" test for determining whether investment in excess of Section 310 limits should be

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approved. Second, I would maintain the general ban, now in Section 310(a), on foreign governments or their representatives owning radio licenses.

As to the changes, I would first suggest that Section 310(b) be rewritten to eliminate the artificial distinction in regulatory treatment of foreign investment based on the corporate structure of the applicant. Congress could amend Sections 310(b)(3) and (4) so that in the event a foreign entity proposes to acquire a greater than 20 percent interest in either the licensee or its parent holding company, the FCC would adjudge the application under the public interest standard. Today there are different percentage limits depending on whether the investment is direct or through a holding company.

Second, I would suggest that a revised Section 310(b) explicitly incorporate a comparison of competitive opportunities in overseas markets to those in our markets as part of the FCC's "public interest" analysis. In other words, when an applicant seeks to invest above the Section 310(b) limits, the FCC should consider -- as part of the total public interest test -- whether a U.S. entity would have equivalent competitive opportunities in the foreign applicant's market. One of the Commission's important public interest goals -- fostering competition in global communications markets -- is furthered by the participation of U.S. companies in markets overseas. The prospect of entry to our market -- which represents about 25 percent of the global telecommunications market -- should be sufficiently enticing that foreign governments will strive to ensure that U.S. entities are afforded equivalent opportunities to compete in their markets. But it is important that such an approach be sufficiently flexible so that it increases, and not decreases, competitive opportunities abroad for U.S. industry.

Third, I would suggest that any new legislation which incorporates the concept of equivalent competitive opportunities should be flexible enough to permit the FCC to be forward-looking. It should allow the United States to take into account new developments in foreign countries. For example, the FCC should have the discretion to approve a transaction with the precondition that planned changes in a foreign country occur. This would eliminate one of the difficulties often associated with a reciprocity approach: that is, who goes first? The answer is, we go together.

Fourth, any new legislation should not require "mirror image" reciprocity. The successful transition of a foreign market from a monopoly to a competitive environment hinges upon the technical details of the overarching regulatory framework. And no two countries have identical regulatory frameworks. I would suggest further that new legislation should not require an identical service sector to be open in order to allow a transaction to proceed under Section 310(b). As the communications market evolves, future technological advances will make it increasingly difficult to identify identical service sectors; a regulatory scheme which is too rigid would inhibit the progress of technological innovation. The focus should be first on competitive opportunities in similar sectors, and, when appropriate, in other communications sectors. Both should be considered in determining whether the public interest would be served by a particular transaction.

Fifth, I believe that an equivalent competitive opportunities approach should permit the FCC to offer more than a simple yes or no answer to a proposed transaction. In other words, a transaction need not be simply approved or denied. Instead, we should be able to grant a specific application to the same extent that the subject foreign country affords U.S. entities equivalent opportunities to compete in its market.

Finally, I would like to turn briefly to Section 310(a). I believe that the general restrictions contained in Section 310(a), which prohibit foreign governments or representatives of foreign governments from holding radio licenses, remain valid. I would, however, urge you to consider a minor modification of Section 310(a) to exempt satellite newsgathering facilities from that restriction, leaving the Commission discretion to deny licenses in cases where foreign governments refuse U.S. news organizations opportunities to compete in their countries.

This provision creates great uncertainty for U.S. broadcasters about the continuing availability of overseas satellite newsgathering capability. Many foreign newsgathering organizations are part of their governments. Therefore, Section 310(a) prohibits them from holding a license for satellite newsgathering in the United States. In response, foreign governments often prohibit or threaten to prohibit U.S. entities from engaging in satellite newsgathering activities in their countries. Ironically, few overseas broadcasters even have the facilities to do satellite newsgathering here. But they know we cannot license them, so they will not license our broadcasters. Thus, while exempting satellite newsgathering appears a minor modification to Section 310(a), its import is far greater to the U.S. entities engaged in satellite newsgathering activities.

Before I conclude, I would like to expand on why I believe the public interest should continue to be the touchstone for the analysis of foreign investment -- and why I believe equivalent competitive opportunities should be an important, but not necessarily an outcome determinative, factor.

One can imagine a case in which a foreign country does not afford equivalent opportunities to compete -- but the proposed transaction would be so important for competition in the United States that it should be approved. On the other hand, one can imagine a case in which, despite equivalent competitive opportunities abroad, national security concerns, foreign policy concerns, or trade policy concerns would suggest disapproving a transaction. My suggestion is that the flexible approach of a public interest standard which retains the government's discretion to respond appropriately to those scenarios would best serve U.S. interests.

I am not suggesting, however, that the F.C.C. make determinations about national security, foreign policy or trade policy. These areas are not within our traditional domain or competence. Rather, the Executive Branch has the expertise on these matters. Therefore, it would also be appropriate to include a requirement that any application subject to Section 310(b) be simultaneously notified to the Executive Branch. I believe that this would further the U.S. government's ability to ensure that the purpose of the law is fulfilled effectively. Finally, let me emphasize one last point. I fully support the Administration's goal of full market liberalization and competition on a multilateral basis. I hope that the approach I have discussed will be only an interim measure. The success of the GII depends on a comprehensive, not piecemeal, liberalization scheme. Accordingly, I support the objective of obtaining a successful GATS agreement by April 1996, thus achieving full liberalization of the telecommunications markets on a multilateral basis.

Conclusion

Mr. Chairman, I want to thank you again for the opportunity to appear before this Committee and testify about this important issue. I would be happy to answer any questions that you may have about my testimony.

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The CHAIRMAN. Professor Noam.

STATEMENT OF ELI NOAM, DIRECTOR, COLUMBIA INSTITUTE FOR TELE-INFORMATION, 809 UNIS HALL, COLUMBIA UNIVERSITY

Mr. NOAM. Thank you, Mr. Chairman, Senator Hollings.

Last June, I had the pleasure of chairing a panel at Brussels with you, Mr. Chairman, as a speaker, and I well remember that you were quite conciliatory, promising to reduce U.S. ownership restrictions to the best of your abilities, and your Europeans respondents would not budge. They claimed to be wide open, and the United States to be the restrictive country. I felt like Alice in Wonderland.

The CHAIRMAN. So did I.

Mr. NOAM. A few days later, you addressed the Senate and that speech did not get the attention it would get today, so let me quote a few sentences: "I found this summit to be a real eye-opener. I was horrified, and that is not too strong a word to use, by the unremitting resistance of the Europeans to my polite suggestion that they need to open up their telecommunications market."

I think this frames the background to the 310(b) revision well. The questions that must be addressed are how to deal with protectionism in our own country and telecommunications law, and how to get other countries to do the same.

It makes no sense for the United States to maintain ownership rules dating back to 1914 when a German-owned high-powered radio transmitter on Long Island sent messages to German naval ships in violation of American neutrality.

Unfortunately, different countries are at different points of telecom policy evolution. In Europe and the Pacific, many countries are moving today from State monopoly to competition. This is an historic process marked by painful and often slow progress, and by significant internal opposition.

The progress that has been made deserves credit, but there's still a long way to go. In the meantime, it is best for us not to be confused by liberalization that is more smoke and mirrors than fiber and microwave, paper liberalizations with none of the details worked out, and "everything-except" liberalizations, opening everything, except 85 percent of the respective telecommunications market represented by voice and intrastructure.

The U.S. is not fully open, either. For the U.S., therefore, one of the options is to open its market unilaterally. That is the approach taken by Representative Oxley's bill. The arguments for unilateral market opening are that we should not care if others restrict their own markets and hurt their own economies. We should instead make the U.S. market more open and competitive. By setting a shining and successful example, the United States will lead, shame, and attract others into following.

The problem of this approach is that it takes away inducements for other countries to open their markets to American carriers and service providers. Such negotiations are taking place as part of the general agreement on trade and services. The restrictions abroad on U.S. companies have been estimated to add up to huge amounts in terms of American jobs, dividends, equipment, software, and trade balance.

Second, unilateral opening tilts the level playing field, much along the way that you, Senator Hollings, suggested earlier for the airline business.

This leads, then, to the question of reciprocity. The problem with reciprocity, however, is that it is easy to state as a general proposition, but very hard to operationalize. Nobody stands still. Every market is different. There are hundreds of submarkets, each with its own particular rules. So what to do?

Strictly speaking, this is one of the situations where you need not do anything, since the FCC has already discretion to let nongovernmental foreigners own anything they want as long as it is not contrary to the public interest.

Practically speaking, however, you want to reform section 310(b) to focus thinking, set national policy, reduce uncertainty, send a signal to other countries, and take away a molehill from those abroad who would make a mountain out of it in order to resist liberalization. It is a molehill, because already today a foreign telecom company can own virtually anything in the United States except over-the-air licenses, and even those they can lease and resell, or even own if the FCC becomes more flexible.

I have several short comments on the draft bill itself First, I like the fact that you do not try to micromanage. You should resist calls for greater specificity of criteria for determining a foreign market opening, or for mirror-image reciprocity.

Second, I would let the FCC rather than the U.S. Trade Representative make the determination on market access. It has the expertise, staff, and ability to compare U.S. conditions. Its independence can also provide some shelter if the determination is unpopular. As a practical matter, the USTR would likely follow the FCC's findings anyway.

Third, I would add a concrete incentive for other countries to reach multi- or bilateral agreements with the United States. Progress in the GATT's round will be very difficult to achieve, so every little bit of help counts.

This could be done by adding a phrase in the bill to the effect that a multilateral or bilateral agreement on telecom trade among the United States and other countries would constitute such a determination of adequate openness unless expressly excluded in the agreement.

Fourth, to reduce litigation for dilatory purposes, you could add language that makes the granting of a stay by a court presumptively unlikely.

I have a few other smaller comments, but I think I can in the interests of time I will leave them in my written comments.

To conclude the United States should offer in its legislation what could be called an "anticipatory flash cut," with full American market opening being assured to other countries conditional to reaching a multilateral trade agreement. This would give us the high ground and help the reciprocity spiral moving toward liberalization rather than away from it.

Those other countries that are committed to market liberalization should have no problem with these provisions, and those that are less committed might find them another reason to reevaluate their restrictions to competition.

Senators I appreciate the opportunity to speak to you.

[The prepared statement of Mr. Noam follows:]

Testimony on foreign ownership reform before the U. S. Senate Committee on Commerce, Science, and Transportation on SR-253

March 21, 1995.

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Chairman Pressler, Senator Hollings, Members of the Commerce Committee:

Last June I had the pleasure to chair a panel at a CEO summit in Brussels, with you, Mr. Chairman, as a speaker. I well remember that you were quite conciliatory, pointing to instances of American protectionism such as the restrictions on foreign ownership in communications. And yet, the European respondents would not budge. The U.S. was described as anti-competitive, while Europe was wide open. I felt like Alice in Wonderland. A few days later, on June 16, 1994, you addressed the U.S. Senate. That speech didn't get the attention it would today, so let me quote a few sentences:

> ...I found this summit to be a real eye-opener. I was horrified--and that is not too strong a word to use--by the unremitting resistance of the Europeans to my polite suggestion that they need to open up their telecommunications market . . . [They] have little interest in breaking down their commercial barriers . . . [They] talk a good line about opening their telecommunications market, but to American firms trying to crack Fortress Europe, this progress appears to be snail-like in pace.

Today, we are engaged in the next major round in the evolution of American telecommunications--continuing the efforts of both parties, all three branches of government, and the States--to move from regulated monopoly to open and deregulated competition. Two of the questions which must be answered are how to deal with the vestiges of protectionism in our law and regulation, and how to get other countries to do the same. I am happy to see that you have addressed both questions as you promised in Brussels a year ago. The FCC, too, issued a Notice of Proposed Rulemaking. Vice President Gore raised the issue last month in Brussels at the G-7 meeting. And, the Commerce subcommittee of the House of Representatives just held hearings on Congressman Oxley's HR 514.

It makes no sense to maintain ownership rules dating to 1914, when a German-owned high-power radio transmitter on Long Island, N.Y., sent messages to German naval ships in the Atlantic in violation of American neutrality. (The 1912 Radio Act still permitted indirect foreign ownership). In the best of worlds, all countries would fully open markets to each other in multilateral free trade. Unfortunately, countries are at different points of telecom policy evolution. The UK, Japan, Australia, New Zealand, and Sweden are reasonably open to domestic and sometimes foreign competition, or about to become so. Yet, even the UK--everyone's Exhibit Nr. 1 for openness--moved out of its cozy domestic duopoly arrangement only in 1991 and still maintains a closed duopoly for international service. And in cable TV service Britain let in Americans only when not enough interested Europeans showed up.

Of the other countries of Europe and the Pacific, many are moving from state monopoly to competition, but many still have a long way to go. It is a historic process, marked by painful progress that we should applaud, and by significant internal opposition that we should recognize. It is best for us not to be confused by liberalizations that are more smoke and mirror than fiber and microwave: *paper liberalization*, with none of the details worked out;

eye-gleam liberalizations, promising the future--Europe 1998, Singapore 2007--and *"everything except" liberalization*, opening "everything except" 85% of the respective telecommunications market.

No doubt, many of these countries will become competitive, but what do we do in the meantime? Is it a second-best solution for the US to open unilaterally, or is it third-best only, less preferred than requiring reciprocity?

The arguments for unilateral market opening are that we should not care if others restrict their own markets and hurt their own economies; let us focus instead on making US markets even more competitive, attract foreign investment and technology, give consumers more options, and protect freedom of expression. By setting a shining and successful example the US will lead, shame, and attract others to follow. Moreover, a full and unconditional opening is easy to administer.

One drawback to this approach is that it negates any inducement for other countries to open their markets to American carriers and service providers. Such negotiations are taking place now as part of the GATS, optimistically scheduled to be concluded by April 1996. These restrictions have been estimated in one study (Economic Strategy Institute) to represent almost one trillion dollars of revenues denied for the decade of the 90's ($874 billion for 9 years, $81.2 billion this year), and rising. Another study (Strategic Policy Research) similarly finds that by removing impediments to free trade, and reforming the international settlement rate system, the U.S. would experience growth of 120,000 to 260,000 new jobs, increase GDP by $120 to $160 billion, and improve the overall balance of trade by $50 to $60 billion per year. We need not accept those numbers beyond observing that they indicate big ticket items affecting American jobs, dividends, equipment sales, information services, marketing opportunities, and the trade balance. Operations abroad may also generate economies of scale and scope benefitting American consumers at home.

Second, unilateral opening tilts the level playing field. Networks are not like refrigerators where the best and cheapest tends to win in the marketplace. One buys connectivity from point A to point B; but if A is open to all while B is restricted to its own monopoly company, that company will get the business. Consumers today want seamless one-stop service, which gives competitive advantages to a company controlling a critical and protected territory, even if it has no efficiency advantage. Such a protected foreign company could, for example, extend its domestic monopoly over its customers vertically into the US by carrying all of that country's outgoing traffic inside the U.S. to the local market, effectively taking that traffic away from competition among carriers for enduser business. For global competition, both points A and B need to be open,, not just one of them.

Thus, a unilateral removal of barriers may benefit Americans as consumers in the short run but harm them as producers of communications equipment and services over time. And the benefit to consumers will be moderated by the fact that most American communications markets likely to be targeted by foreign entrants are already substantially competitive.

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This leads to the question of reciprocity. The problem with reciprocity is that it is easy to state as a general proposition but hard to operationalize. Nobody stands still, every market is different, there are hundreds of submarkets, each with its own particular rules.

Also, reciprocity requirements beget the same requirements, or stricter ones still, by other countries. Thus, one may reach a "reciprocity gridlock" that encourages continuous and time-consuming inter-governmental negotiations--like last month's high-visibility but low-productivity G-7 event in Brussels.

So what to do?
Strictly speaking, you need not do anything, since the FCC already has discretion under 310(b)(4) to let non-governmental foreigners own anything they want to so long as it is not contrary to public interest. The Commission has historically interpreted this quite narrowly, but Congress can always redefine the public interest for the Commission. It seems the FCC is already doing so in its NPRM. Even the FCC need not issue any new rules and simply exercise its statutory discretion in a new way. Practically speaking, however, you want to reform section 310(b) to focus thinking, set national policy, reduce uncertainty, send a signal to other countries, and take a molehill away from those who would make a mountain out of it in order to resist liberalization. And it **is** a molehill, because already today a foreign telecom company can own virtually everything except over-the-air licenses--and those they can lease and resell.

Your bill gives us back leadership and the moral high ground, by invalidating 310(b) conditionally on a USTR determination. This is a sound approach. I have several comments.

First: I like the fact that you do not try to micro-manage the conditions for market opportunities, and market definition. The shifting circumstances of any test defy codification, and you should resist calls for greater specificity by any interest group. It is much better to leave this to the FCC which has already embarked on the task. What your committee could do, however, is to give signals to the FCC that you do not seek mirror-image reciprocity; and that the determination should be based on actual telecom outputs, rather than on the minutiae of rules as inputs. For example, are telecom prices much higher for carriage from country X into the US than in the opposite direction?

Second: let the FCC rather than the USTR make the determination on market access. It has the expertise, staff, and ability to compare US conditions. Its independence can also provide some shelter if a determination is unpopular. As a practical matter, the USTR would likely follow the FCC's findings anyway, just as the FCC would accept the Executive's policy lead. If Executive branch authority is critical, you could give both the FCC and the USTR the ability to make a positive determination without requiring the other to concur.

Third: I would add a concrete incentive to other countries to reach multi-lateral or bi-lateral agreements with the US. Progress in the GATS Round will be difficult to achieve, if one considers that in several years of the Uruguay Round no basic telecommunications agreement was reached. So every little bit of help counts. This could be done by adding a phrase to the effect that "a multi-lateral or bi-lateral agreement on telecommunications trade among the United States and other countries would constitute such a determination, unless expressly excluded in the agreement."

Fourth: To reduce litigation for dilatory purposes after a determination, you might want to add language that makes the granting of a stay by a court presumptively unlikely.

Fifth: I would substitute for the drafted condition ("mutually advantageous market opportunities") the term "effective market access." The former, by requiring mutual advantage, might not be met if an American company proves too successful. The latter matches the FCC's terminology, which has the advantage of being already part of a rulemaking process that would clarify standards and definitions.

Relatedly, the draft language speaks of "market opportunities for...*licenses*." Yet a license could be granted to a US company under circumstances that still prevent competitive viability, such as without interconnection arrangements, access charges that create a price squeeze, etc.

Sixth: While the inclusion of broadcasting as open to foreign ownership is correct, it is also true that the issues in broadcasting are different than those for common carriage, being more connected with general standards for broadcasters. I would not want to see the common carriage element fail to receive a majority by being tied to broadcasting. Therefore, you may want to deal with broadcasting separately.

Seventh: It is not clear in the draft language whether a determination of openness is required for all of the media listed (broadcast, common carriers, or aeronautical enroute or fixed radio stations) or for either of them singularly.

The second part of the draft bill section deals with a "Snapback for Reciprocity Failure." The intent of this clause is to put some teeth into enforcement, which is laudable. However, the present language invalidates existing licenses upon the USTR determination of non-openness, which will be destabilizing. Other countries, no doubt, will enact mirror image provisions, and this will provide a tool for governments to periodically threaten American companies' licenses abroad. For this reason, I would leave the actual remedies to the FCC. Such remedies could then include, for example, partial or gradual divestiture, stricter controls of interconnection and unbundling, or other safeguards, rather than the all-or-nothing of a license loss that might, in fact, discourage a negative determination in the first place.

Finally: while you are at it, there are a few other dusty ownership restrictions on the books that you may want to give a proper burial also, such as the Telegraph Act of 1900 and the Submarine Cable Landing Act of 1921.

Conclusion: A unilateral flash-cut opening has the advantage of simplicity but reduces leverage in the upcoming trade negotiations. Instead, the United States should offer in its

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legislation an "anticipatory flash cut," with full market opening in the US already being assured to other countries upon reaching a multilateral trade agreement. This would give us the high ground, and help the reciprocity spiral move towards liberalization. Even without a multilateral agreement, your bill will increase openness and consumer benefits at home, reward similar openness abroad, and increase opportunities for American exporters. Those other countries that are committed to market liberalization should have no problem with these provisions, and those that are less committed might find them another reason to reevaluate their restrictions to competition.

Senators, I appreciate the opportunity to speak to you, and am ready to be of assistance on this or other topics of the major reform task before you.

The **Chairman**. Thank you very much.

Let me ask you, because I remember that speech at Brussels, and the Europeans said their markets are open and the U.S. market is closed. I guess we have this foreign ownership thing in there as a wedge to try to enable our people to invest overseas. They run into enormous problems, even though there is a lot of rhetoric that surrounds this.

Generally speaking, which markets in the world are the most open? And also then, some people say well, there might be some little country like Panama, or you name it, that has no restrictions on our investment, so a company will just move there, have their corporate headquarters there, invest in the United States, funnel the money through, and they will circumvent the real intent on what you are trying to do. How would you each deal with those questions?

Mr. **Harris**. Senator Pressler, let me deal with your last point first. I think you are correct, there is the possibility of a company trying to move its headquarters and circumventing the rules.

I think any attempt to deal with this issue has to be willing to pierce the corporate veil and look to the real, primary market of the company in question, so that it cannot operate through a sham subsidiary, reincorporate itself, or use some other device to avoid the clear intention of the legislation.

Second, to deal with your first point in terms of which markets are most open, I would say the United Kingdom, if one had to choose one, was a market that, as you yourself have said, is very open, and has reaped enormous benefits as a result. Our market, too, is much more open than the Europeans believe, but we do have a perception problem. And that is exactly why legislation, rather than attempting to handle it through the regulatory process, is important. Because it sends a clear message to the rest of the world about the political will behind the policy decision.

Mr. **Noam**. The U.K. is open, but even it moved away from a cozy duopoly system only 3 years ago, and that duopoly still exists for international service. United States carriers are active in U.K. cable, but they were let in only when no Europeans showed up as investors.

New Zealand, Australia, and Sweden are fairly open. Japan is fairly open for domestic issues, and in the process of presumably loosening up on de-facto foreign participation. Germany is getting there after it scales some political hurdles. Several of the other Europeans are moving, with different degrees of enthusiasm. Company and party politics are always complex.

Mr. **Harris**. Senator, if I could just add something more, the last study I saw suggested that approximately 85 percent of the EU telecommunications market is still closed to foreign participation, so there is a long way to go, despite their rhetoric. And I think the legislation you are considering may nudge them along. It may, indeed, shove them along to making their rhetoric a reality.

The **Chairman**. I have some more questions, but I will yield to my colleague, Senator Hollings.

Senator **Hollings**. Well, most respectfully, I do not see the problem that you two gentlemen are trying to solve. Of course, there is no witness for the present policy, and it is not up to me to be attesting to that particular policy, but this so-called open, open, open, the present policy has been well-founded in this Senator's judgment.

I do not understand what you are talking about when you come to the regular investment and the marketing, then we are all over the world. You are right, we are into the United Kingdom. We have got RBOC's investing in Mexico and New Zealand. Bell South is putting in the communication system for the city of Buenos Aires down in Argentina. We have got investment all the way around the world.

But when you come to actually—like we have the Voice of America, the voice of people in this country to be able to broadcast in Germany or in New Zealand, or wherever, why is that a national problem?

I mean, I have been in more international conferences than you two gentlemen have. I have been in every country, almost, in the world including up at Point Barrow and the South Pole, and I have yet to have this kind of problem where you have got your own communications. It is not just for national security, it is a matter of the taste and the fear with respect to violence in certain programs that are put on in other countries.

Mr. Harris, where is the problem that you are talking about? I understand they had a conference in Brussels, but I mean, where have you seen the problem about all this investment? We have got enough room for investment the world around.

In fact, that has been the policy with respect to the RBOC's. That is why we have got a manufacturing provision. We forced them to invest overseas. The problem has been, they have not been investing enough here, and that is why we are going to change the manufacturing provision so we hope they will begin to manufacture all these communication entities here.

I do not see the foreign problem, other than some kind of academic "openness." What is the national problem you see?

Mr. HARRIS. Senator, first let me say there is much about what you say that I agree with. I think in many respects the current policy has, indeed, proved valuable, and that is why I suggest, among other things, we ought to retain the current public interest test.

Keep in mind, all I am suggesting is that when we consider the public interest, we take into account, not necessarily outcome determinative, but simply take into account whether foreign Governments treat U.S. industry fairly. Let me address the question of whether it is——

Senator HOLLINGS. Do you mean U.S. broadcasters? When you say industry, let us get right to the point: broadcasters, because we know the communications companies, the cable and the regular wire services and everything else, satellite and everything, all the rest of that is taken care of. They can invest the world around, and we have got Siemens and Northern Telecom and everything else around here manufacturing. It is a very viable, competitive situation. All sides are investing. But when you come to the actual broadcast, where is the problem?

Mr. HARRIS. I think, again, you raise an interesting issue, and let me tell you how I would approach it. It seems to me that when one considers the public interest, even for broadcasting, there is nothing untoward about considering as one of the factors whether or not a foreign Government treats U.S. industries or U.S. broadcasters fairly.

Now, let me be candid, though. If you adopted such a minor alteration to our existing public interest test, you would have no effect whatsoever today. And I mean none, because all across the world, broadcasting markets are closed to foreign investment in very much the way they are closed to foreign investment in the United States.

Let me add that while there is enormous movement in the telecommunications sector, there is no such movement in the broadcast sector. So, if you adopted legislation akin to what I am suggesting, there would be no real world difference today or in the immediate future.

So then the obvious question is, why suggest it at all? I would say to you only that all of the panels we have heard before today suggest that this industry is evolving, and I am the last person to know how it is going to evolve, but you have heard them talk about convergence.

You have heard the broadcasting people say how they are going to be able to provide perhaps voice services, provide digital information transmission. You have already heard about the phone companies providing video, the cable companies providing voice. It may be over time this issue, or the industry, rather, will evolve, and you will want in place a statutory mechanism that allows your regulatory structure to evolve with it. But you have to understand, today it would make no difference whatsoever. And you are correct, in broadcasting for today, you are really talking theory.

Senator HOLLINGS. Well, you can rent a country, as the question by the chairman indicates. This committee started off as the Committee on Foreign Commerce, and we know from licensing of vessels all about the Panamanian and the Liberian tankers, and you can rent one of those countries and they can be located there.

And the wealth of an individual, when you talk about Governments, let us go down to Mexico. An individual owns that broadcast entity, and in fact we know it up here very, very vividly. At the Committee of Commerce we had a hearing going on last year, and in the middle of that particular hearing, being beamed by satellite from Mexico City, they did not like what the witnesses were attesting to right at that same table, and Emilio Ascaguera, who owns that broadcast, he just cut it off.

So you think you have got a Government, I mean, we are all learning now in the headlines on the front page that individuals own Mexico, the PRI, just a small group of them, and so that has been the problem.

So just talking about Governments and individuals does not satisfy my concerns. I do not see the big problem on national concerns that you have, other than the fetish you have about openness, openness, openness, and that is wrecking the economy of this country right now, there is no doubt about it.

If anybody thinks NAFTA is working, I have got 14 industries that have left South Carolina to go down there to do what, to avoid what we as Senators require from a minimum wage to clean air to clean water to plant closings, to parental leave, to social security to health care, to safe working place, to safe machinery, and on and on and on.

And so I put all the requirements on that local industry, and they say, ta-ta, and goodbye, we can go right across the line and ship back in. This is like moving the industry to Texas, it is a wonderful operation. And we wonder why we are going out of business.

I think you had an answer, Mr. Noam.

Mr. NOAM. Senator, you are focusing on the broadcasting field, and indeed, I agree with you that if you separated it from the telecom side, there would not be much harm.

However, on the telecom side the United States is a potential large exporter, and we are hurting ourselves by these rules. The United States, because of its competitive system, has now a very efficient industry that could become a service provider to the world, and in its wake are software and information services, and one reason slowing these exports is because other countries have restrictive rules.

Senator HOLLINGS. Mr. Noam, we know differently. We have had hearings on all that. Software has moved to Malaysia. They say, we do not want any textile industries, we want the software industry, and when we had the other hearings with respect to the RBOC's in the long distance, we pulled back the press boards of the AT&T on manufacture, and all the little capacitors and everything on the back of the board had "Made in Taiwan." The communications industry is gone.

I mean, we have got the potential. We have had the potential, but it is gone, and we are trying to get some of it back. The problem is the exact opposite of what you are talking about.

Mr. NOAM. In the United States, for example, the number of employees per telephone line is 10 times less than it is in India. The United States telecommunications industries, because of the competitive environment, has become efficient and customer-oriented. We can provide service in other countries, where the telecommunications organizations are not responsive in the same way. The way to gain entry to those countries is to get our own restrictions into order, and that is what the FCC and the White House advocate, and that is what this bill enables the FCC to do.

Senator HOLLINGS. Well, you and I could go at it at length, no doubt. I mean, we have learned the hard way. For 50 years since World War II we had Adam Smith open markets. No one followed us. The truth of the matter is, they all follow Frederick Liszt and the Japanese system, whereby the wealth of a country is measured not by what you can buy, but what you can produce, and economically we are on the ropes, and everybody ought to sober up and understand it.

I mean, even the East European countries, very interestingly, Romania and the entities of the former Soviet Republic, are now following not Adam Smith and open markets, the governmental decisions are not whether it is open or not, or a level playing field, it is whether or not it strengthens the economy of that country, and this is the same thing we would be into in communications.

Setting the nice little example that you folks think of academically, we tried that for 50 years. We have tried it for 50 years, and it just has not worked, and now we are having to move like we recently moved with the Chinese question, under the matter of copyright and the CD's and so forth, the patents that we just were going to cut them off from our markets unless they, by gosh, cut out violating our patent rights and our CD's. Now we finally are using market access in the United States to get that so-called level playing field.

But your particular approach of opening up and setting a nice example, we tried that for 50 years otherwise, and it has really been a disaster.

Mr. NOAM. Senator, we are not arguing here for "unilateral disarmament" in telecom trade. This gives the Trade Representative the ability to declare another country open to American companies, and only then would those companies from those countries have market access of a similar kind in the United States.

Mr. HARRIS. Senator, I might add, I may have been less than clear, and for that I apologize. It is, indeed, our view that our markets ought not to be open to those who would restrict access to their markets. I share your view entirely on that issue, and what we propose is simply giving us the ability to allow into our markets those who have done the same for American corporations.

Senator HOLLINGS. Thank you, Mr. Chairman.

The CHAIRMAN. Just following that up, let us say that—and indeed, I am not for this, but let us say that the other countries do not open up their markets. Would we still be better off in getting capital into the country that would expand our industrial base—to have our markets open?

Mr. HARRIS. Senator, I would say that it is an advantage in many ways to have capital come into the market regardless of what happens.

However, if you take the market on balance, I come out the other way: that it is important to use our leverage to pry open foreign markets, and let me explain to you why. For us, it is a question of competition. The communications market is globalizing. You can see it in the papers every day, global alliances, worldwide satellite systems and the like.

If a foreign entity can offer GM seamless global services because it can do business here and elsewhere, but AT&T cannot offer those services because it can only do business in the United States, you have distorted competition. You have distorted competition in the emerging global marketplace, and that is what we hope to protect. Because we believe the very best competitors in this industry are U.S. competitors, which will mean more jobs in the United States, more competition in the United States, more economic growth in the United States.

The CHAIRMAN. What are the issues in foreign ownership in terms of national security implications?

Mr. HARRIS. As you know, Senator, the current test, or current public interest test, includes an evaluation of the national security. I think that is valuable to retain, and that is one of the reasons I suggest we retain the public interest test.

If the executive branch comes to us in a given case and says, there is a national security problem with this application, it seems to me appropriate for the FCC to defer to that kind of decision by the executive branch. We cannot make our own independent analysis, needless to say, of national security issues.

Today, it may happen in a rare case, but one can hypothesize such a case, and my view is the legal system ought to be in place to allow you to react, if that rare case arises.

The CHAIRMAN. Do you have any thoughts on that?

Mr. NOAM. The United States Government is precluded from becoming a broadcaster in the United States itself, and it would make no sense for a foreign Government to have such a right. Therefore, I would support maintaining the restrictions against foreign Government ownership in the United States.

The CHAIRMAN. Well, let us say a foreign Government would give an individual the money to buy a station, and engage in some activities that would be the same as their Government would. How would we prevent that?

Mr. NOAM. I trust that the FCC would look to that.

Mr. HARRIS. Again, Senator, the public interest test includes national security concerns, foreign policy concerns, and other concerns.

The CHAIRMAN. Thank you. I may have some additional questions for the record.

I thank you very much for waiting so long this morning. It is always hard on the last panel, because a lot of these Senators go off to lunch or somewhere. I am sure they are all working, having said that. But thank you very, very much.

[Whereupon, at 12:55 p.m., the committee adjourned.]

APPENDIX

MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL

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EXECUTIVE DIRECTOR,
MINORITY MEDIA AND
TELECOMMUNICATIONS COUNCIL

BEFORE THE COMMITTEE ON COMMERCE,
SCIENCE AND TRANSPORTATION,
UNITED STATES SENATE

ON TELECOMMUNICATIONS REFORM
LEGISLATION

MARCH 22, 1995

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Mr. Chairman and Distinguished Members of the Committee,

Thank you for graciously providing me with this opportunity to present the views of the Minority Media and Telecommunications Council ("MMTC") on telecommunications reform legislation.[1] My statement will focus on the broadcast multiple ownership rules, 47 C.F.R. §73.3555, on the alien ownership provisions of Section 310 of the Communications Act, and on the need for universal service by providers of telecommunications and video services.

I. Broadcast Multiple Ownership

The Minority Media and Telecommunications Council unequivocally stands for diversification and localism in one of our greatest national resources, the radiofrequency spectrum.

On such issues as crime, welfare and health care, Congress is considering how to shift the balance of power from the national level to the local level. Congress should adopt a similar approach for broadcasting. It should avoid legislation which would vest in New York City and Hollywood -- and remove from local businesspeople -- the ability to decide what the American public sees and hears.

Legislation to further accelerate concentration of control in broadcasting is especially inappropriate in an industry whose greatest asset is creativity. Creative thinking flows from the bottom up, not from the top down.

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[1] MMTC is a nonprofit association of attorneys, scholars, engineers and economists. Since 1986, it has provided research and legal support to the national civil rights organizations on matters of communications policy. In my private capacity, I am one of the attorneys representing various units of the NAACP before the FCC in challenges to whether Fox Television Stations, Inc. violated Section 310(b) of the Communications Act. MMTC emphasizes that it takes no position on the merits of that litigation or any other adjudicatory case. The views expressed in this testimony are the carefully considered views of the Council institutionally. This testimony does not necessarily reflect the views of any particular member of the Council or any member of its Board.

Protections against media concentration are especially critical for minorities. Minority broadcasters, almost without exception, are small broadcasters. Minorities own only 2.7% of broadcast stations, and these stations amount to less than 0.5% of broadcast industry asset value. Most minority owned radio stations operate in the AM band, which now enjoys only 19% of radio listenership. Many of these AM stations are uncompetitive, upper band, daytime-only facilities: the "dogs" of the spectrum which nobody else wants.

Today, minority broadcast ownership is an endangered species, given the possible repeal of the tax certificate policy, which is responsible for 2/3 of all minority owned stations. Furthermore, the current economic climate renders it profoundly difficult for minorities to finance startup stations or stand-alone radio stations and keep them on the air while struggling for a piece of the advertising pie.

We need only look at similar industries which grew without multiple ownership rules -- cable television and daily newspapers -- to soothsay the fortunes of minorities in broadcasting if the multiple ownership rules are repealed. In newspapering and cable, as in agriculture and food retailing, minorities and most small businesses generally were unable to compete with huge multiple owners who were able to extract competitive advantages from their group holdings. A small, stand-alone broadcast station is no match in the marketplace for a powerful combination of several larger stations which can out-finance, out-program, out-sell and out-price the small operator at will.

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Ten years ago, in Multiple Ownership Rules (Reconsideration), 100 FCC2d 74, 94-95 (1985) (history omitted), the FCC recognized that "our national multiple ownership rules may, in some circumstances, play a role in fostering minority ownership." Today's FCC is considering a rulemaking proposal which would link increases in the number of stations a company may own to the company's efforts to invest in or finance minority owned stations. This "incubator" concept was first developed by President Bush's FCC Chairman, Alfred Sikes. The concept only works if the multiple ownership rules remain in effect; otherwise, there will be no incentive to "incubate" anything. Absent positive incentives, nonminority broadcasters seldom voluntarily go out of their way to assist minorities to join the ranks of station owners.

Broadcast diversification is like the rain forests -- once plowed under, it will never return. For four decades, as the industry grew, diversification grew. The resulting panoply of small business owners, including minorities, gave our airwaves the diversity of information which makes our system of broadcasting unique in the world. It would be a national tragedy, of immense proportion, if Congress tells the FCC to shut the doors on minorities and small business owners forever.

II. Alien Ownership

The restrictions on alien ownership in Section 310 of the Act has served us well and should be retained. Unlimited foreign capital invested in American broadcasting would eviscerate the public interest standard which has undergirded broadcast regulation for most of this century.

Repeal of Section 310(b) would literally permit the airwaves to be sold off to the highest bidder. That would be a tragedy. It would destroy years of careful and thoughtful work in constructing the world's greatest system of broadcasting.

Unlimited alien ownership in American media would make broadcast owners even more distant from viewers and listeners than many of them are now. Today, if a radio listener in Peoria thinks a local station's programming is harmful to her children, she can call the owner, whether the owner is in Peoria or in New York City. What if the owner is in Brussels or Berlin? In Teheran or Tripoli? In Osaka or Vladivostok?

In our system of broadcasting, the licensee is ultimately responsible for everything he broadcasts. The "buck stops" with the station owner. Because of that direct accountability, broadcasting has been freed even of indirect program content regulation, such as the Fairness Doctrine, ascertainment and program percentages.

The quality of our broadcast service is guaranteed by the FCC's very high standards for licensee character qualifications. Because there are far fewer radio and television licenses than there are people who want them, we have laws and regulations to insure that licensees are not felons, antitrust violators, race or sex discriminators, or drug dealers. We know that an American owned licensee has complied with American laws. But we have *no* realistic way of knowing whether alien broadcast owners have complied with the laws of their home countries -- laws which may be much more relaxed and easier to circumvent than American laws.

Another fundamental reason Congress should not repeal Section 310(b) is that we have not yet completed the task of insuring that all Americans have a chance to achieve ownership in America's most

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important industry. I trust that we as a nation have not given up on our commitment to diversify the public airwaves. And that, above all other reasons, is why the Minority Media and Telecommunications Council opposes outright repeal of Section 310(b).

The primary obstacle facing minorities seeking to break into media ownership is access to capital. Even by taking advantage of the tax certificate policy, minorities frequently cannot win a bidding war with nonminority competitors engorged with the ample resources of those sources of domestic capital which are seldom available to minorities.

Roughly 80% of the world's media and telecommunications investment capital is not American capital.[2] Suppose Congress allows virtually unlimited amounts of that 80% of the world's media and telecommunications investment capital to enter this country at will. If minorities and small broadcasters are forced to bid against alien as well as domestic capital, they will be swamped.

Virtually no foreign equity or even foreign debt finds its way into the hands of minorities. There are two principal reasons why.

First, alien media investment capital arrives in this country only in units too large for most minority deals. Unlike domestic investors, an alien investor typically lacks the knowledge and ability to monitor her investment closely. The administrative cost of managing an overseas investment is not materially greater for a $100 million investment than it is for a $1,000,000 investment.

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[2] Aliens wishing to financially benefit from American media can do so now through debt rather than equity. Debt poses no regulatory problem for the FCC. Loans are freely sold worldwide without the knowledge of the FCC. The FCC tracks equity; it does not track debt. But equity, not debt, is where influence lies. Even noncontrolling equity holders always have greater exposure and decision making rights than creditors.

Consequently, alien funds are generally unavailable to small (and thus most minority) businesses.

Second, alien fund managers and bankers seldom have experienced the culture and traditions -- much less the legal regime -- of civil rights. The Community Reinvestment Act does not apply overseas, nor do precepts against redlining and discrimination in lending. Even alien investors with the best of intentions have little to gain from the long term success of minority entrepreneurship in the United States. On the other hand, all Americans benefit when the minority sector of our economy is strong. Domestic investors, aware of these benefits, frequently act accordingly.

Congress must avoid even the appearance of weakening its defense of minorities' ability to obtain meaningful access to capital and to use that capital competitively. It should remember that the broadcast deregulatory initiatives the FCC launched over the past two decades -- with Congressional approval -- were defended by pointing to the existence of the minority ownership policies as a structural, content neutral and profoundly necessary means of promoting diversity.1/ The D.C. Circuit has expressly approved this

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1/ Beginning almost immediately after it adopted the minority ownership policies, the FCC began systematically deregulating in every other substantive area except EEO: postcard renewals, ascertainment and program content percentage standards, the Fairness Doctrine, five year TV and seven year radio renewals, the duopoly rule, the Top 50 Policy, the 7-7-7 and the 12-12-12 rule, the Mickey Leland (14-14-14) rule, most distress sales (for want of stations placed in hearing), most comparative hearings for new facilities, and the AM clear channel eligibility criteria favoring minority ownership. For example, in Deregulation of Radio (NPRM), 73 FCC2d 457, 482 (1979), the FCC reassured the public that "[e]fforts to promote minority ownership and EEO are underway and promise to bring about a more demographically representative radio industry."

(n. 1 continued on p. 7)

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safety-net approach, endorsing the FCC's reliance on minority ownership as a preferred means of promoting diversification.[4]

A safe environment for minority ownership is socially compelled if we are not to remain forever two societies, one Black and one White. *See* *Report of the National Advisory Commission on Civil Disorders* (1968), Chapter 15. The minority ownership policy is the thin straw upon which the FCC relies to insure that listeners and viewers receive a diverse pallette of information.

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[3] (continued from p. 6)

In adopting its ultimate rules in *Deregulation of Radio*, 84 FCC2d 968, 1036, *recon. granted in part*, 87 FCC2d 797 (1981) *aff'd in pertinent part sub nom. Office of Communication of the United Church of Christ v. FCC*, 707 F.2d 1413 (D.C. Cir. 1983), the FCC held that "it may well be that structural regulations such as minority ownership programs and EEO rules that specifically address the needs of these groups is preferable to conduct regulations that are inflexible and often unresponsive to the real wants and needs of the public." It explicitly concluded that the minority ownership policies and EEO rules, rather than direct regulation of broadcast content, were the preferable means to achieve diversification. *Id.* at 977.

See also *Amendment of §73.636(a) of the Commission's Rules (Multiple Ownership of Television Stations)*, 75 FCC2d 587, 599 (1979) (separate statement of Chairman Ferris), *aff'd sub nom.* *NAACP v. FCC*, 682 F.2d 993 (D.C. Cir. 1982); *Implementation of BC Docket 80-90 to Increase the Availability of FM Broadcast Assignments, Second Report and Order*, 101 FCC2d 638, *recon. denied*, 59 RR2d 1221 (1985), *aff'd sub nom.* *NBMC v. FCC*, 822 F.2d 277 (2d Cir. 1987); *Deletion of AM Acceptance Criteria in §73.37(e) of the Commission's Rules*, 102 FCC2d 548, 558 (1985), *recon denied*, 4 FCC Rcd 5218 (1989); *Nighttime Operations on Canadian, Mexican and Bahamian Clear Channels*, 3 FCC Rcd 3597 (1988), *recon. denied*, 4 FCC Rcd 4711 (1989); *cf.* *Revision of Radio Rules and Policies (Report and Order) (MM Docket 91-140)*, 7 FCC Rcd 2755, 2769-2770 ¶¶26-29 (1992) (relying on minority ownership policies to further diversification goals, even as the FCC *deleted* one of those policies, the Mickey Leland Rule.)

[4] *NAACP v. FCC*, 682 F.2d at 1004 (holding that the FCC "has not improperly exercised its discretion by relying on [its minority ownership, employment and programming policies] rather than the Top-Fifty Policy, to advance minority goals.") Eviscerating the marketplace value of the FCC's minority ownership incentives by eliminating alien ownership protections would necessarily call into question the continued validity of two decades of deregulation.

The bottom line is that unlimited entry of aliens into American media ownership would virtually eviscerate the effectiveness of the minority ownership policies. It would be especially cruel to American minorities to deny them a meaningful opportunity to buy broadcast stations as a consequence of legislation welcoming well-heeled Britons, Russians, and Germans to buy access to the American peoples' airwaves. Congress should not force American minorities to the back of the line and allow wealthy foreigners -- simply because they have money -- to jump to the front of the line. As Americans, we simply need to put our own people first.

If some relaxation of Section 310(b) is considered by the Congress, we have four recommendations on how to somewhat cushion the blow to minorities and small businesses.

First, we should not allow foreign access without reciprocity. Most nations do not allow virtually unrestricted access by American investors in their mass media enterprises. Most Anglophone and Francophone nations have at least a 60% local ownership and equity requirement. Leaders of both political parties disfavor unilateral concessions in trade negotiations. The recent successful negotiation with China over the pirating of intellectual property demonstrates why reciprocity must be part of any liberalization of Section 310(b). If reciprocity is a factor, though, it should be but one of several elements of the public interest test the FCC uses in considering whether to grant waivers -- and it should be a relatively minor element.

Second, if Congress liberalizes Section 310(b), it should do so in a way which fosters minority ownership by addressing the longstanding, almost intractable problem of capital formation. For example, Congress could permit up to 49% alien equity so long as it is invested in a minority controlled company.

Third, Congress should authorize the FCC to permit an alien who makes a substantial investment in a minority controlled broadcaster to hold a larger equity stake in that and other American media holdings than otherwise would be permissible.

Fourth, Congress should create the American Communications Investment Bank as a vehicle to promote diversity in broadcasting through the use of alien investments. The Bank would be a private, nonpartisan institution, operated by Presidential appointees subject to Senate confirmation. The Bank would permit aliens (and others, including U.S. based multinationals) seeking to invest in U.S. media to channel and pool their investments for subsequent subdivision and targeting to U.S. media interests of all sizes, in furtherance of U.S. communications and trade policy.

The Bank would be designed to attract sufficient investment to greatly accelerate the construction of the information superhighway, generate additional tax revenue, and help balance the budget without raising taxes.

The Bank would promote minority ownership in five ways, providing minorities with capital to which they heretofore seldom had access:

1. Its investment decisions would include minority ownership as a primary decisional factor, accounting for at least 30% of the capital invested or loans made, subject to generally accepted prudent lending and investing criteria.

2. Capital flowing through the Bank would not be deemed attributable for the purpose of Section 310(b)(4) of the Act.

3. By its pooling mechanism, the Bank would reduce the transaction costs which prevent small and moderate sized amounts of alien capital from being invested in American media and thus ultimately being accessible by minorities.

4. By its subdistribution mechanism, the Bank would enable large sized amounts of alien capital to be broken down into the smaller sums minorities often require for broadcast acquisitions.

5. The Bank would have the flexibility to make investments, to make loans, or to issue loan guarantees, thus maximizing its ability to harness private sector resources to achieve its business and social objectives.

This is not "affirmative action." It is, instead, a workable means of fulfilling Congress' goal of assisting minorities to acquire the capital needed to compete in the marketplace.

In opening a rulemaking proceeding on alien ownership subject last month, the FCC emphasized that "we have had a traditionally heightened concern for foreign influence over or control of licensees which exercise editorial discretion over the content of their transmissions." Market Entry and Regulation of Foreign-affiliated Entities (NPRM), FCC 95-53 (released February 17, 1995) ("NPRM") at 41-42 and n. 84.[5/] The FCC has asked for comment on "whether we should also consider other factors" besides reciprocal access in evaluating whether to allow additional alien ownership of broadcast facilities." Id. at 44. As the expert agency, the FCC should be permitted to complete its rulemaking proceeding before Congress intervenes.

The Minority Media and Telecommunications Council encourages the Subcommittee not to consider repeal or liberalization of Section 310(b) unless and until a firm, workable and tested mechanism is

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[5/] The FCC cited GRC Cablevision, Inc., 47 FCC2d 467 (1974) and Teleport Transmission Holding, Inc., 8 FCC Rcd 3063 (CCB 1993).

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created to guarantee that the net effect of additional alien ownership will be a dramatic increase in American minority ownership.

III. Universal Service

In fostering the development of a new generation of telecommunications services, including video services, Congress has a wonderful opportunity to insure that all Americans will benefit equally from Day One. This opportunity is particularly desirable in the case of common carriers, with centuries of tradition as providers of equal service to all. An innkeeper, a bridge toll taker, a stagecoach operator, a passenger vessel, an airline, or a telephone company should never say "there is no room at the inn" to any paying customer. That is why the great civil rights decisions of the 1930s through the 1950s -- the desegregation of state universities, buses and airlines -- all turned on the fact that these institutions were common carriers, and a Black or Brown dollar is just as valuable as a White dollar.

Therefore, we encourage the Committee to adopt strong anti-redlining protections. Your proposed legislation should specify that no carrier may exclude any area from any of its geographic service areas on the basis of the race, national origin, income, age or rural location of the residents of the excluded area. No ratepayer should be forced to ride in the back of the bus on the information superhighway because he or she does not reside among the wealthy.

In addition, the Committee should instruct the FCC to develop strong equal employment opportunity rules in telecommunications, and enforce those protections vigorously. The FCC has been particularly negligent over the years in enforcing its common carrier EEO rule, and the Committee should provide appropriate oversight to be sure this rule begins to be enforced.

Conclusion

We hope the Committee will keep these considerations in mind before performing radical surgery on a statute which has meant so much to the American way of life and to the American way of broadcasting and telecommunications.

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STATEMENT OF PAUL J. WONDRASCH
AT&T CORP.
BEFORE THE COMMERCE,
SCIENCE AND TRANSPORTATION COMMITTEE
U.S. SENATE

MARCH 21, 1995

Mr. Chairman and Members of the Subcommittee: My name is Paul J. Wondrash. I am a Senior Vice President of AT&T Corp. I would like to thank you for the opportunity to discuss the issue of foreign ownership restrictions in telecommunications. My testimony will focus on AT&T's views concerning the need to open global telecommunications markets and to ensure that U.S. carriers have effective market access abroad in order to serve their customers' current and future international telecommunications needs.

I will explain why AT&T fully supports the proposal in the draft legislation to revise the Communications Act to make the removal of the U.S. foreign ownership restriction in Section 310 of the Act contingent upon other countries' willingness to open their markets to U.S. telecommunications carriers. I will also discuss AT&T's recommendation that other countries be required to grant U.S. carriers effective access to their markets and to charge U.S. carriers non-discriminatory, cost-based accounting rates before carriers from these countries are allowed to enter the U.S. market.

Anyone who went through the competitive revolution in telecommunications in the United States over the last ten years understands the benefits of competition to customers, and what is good for customers is good for industries and countries. As U.S. business expands internationally, our customers increasingly demand the same high quality and access to information from their international telecommunications services that they have come to expect domestically. But our customers' access to high-quality services overseas is often limited by regulatory and legal practices that have never been changed to reflect the changes that have occurred and will continue in the global telecommunications industry. As a result, most foreign markets have been unable to match the pace and breadth of change in the United States. Traditional closed-market prohibitions are simply incompatible with the promise of technological innovation and the continuing vitality of providers of these new services.

The catalyst which will bring vitality to global telecommunications services is the same one that stimulated competition in the U.S. long distance and telecommunications equipment markets -- full and effective market access by all service providers. We need a global market that provides customers with competitive choices -- a market where communications companies are free to cross national borders to give customers the services they want. In the vast majority of the countries of the world, this type of market access simply does not exist today.

The need for and benefits of competition are recognized just about everywhere today. Some countries have acknowledged the changed circumstances in the industry and are beginning to

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adjust accordingly. Not much concrete action, however, has been taken by most countries outside of the United States to remove barriers to competition in basic services.

The barriers to entry into these markets go far beyond restrictions on foreign ownership. While some countries do impose explicit restrictions on foreign ownership of telecommunications operators, even countries that do not have *in fact* kept their basic voice telecommunications markets firmly closed to any and all competitors.

Germany, for example, has no legal foreign ownership restrictions, but the government-owned carrier, Deutsche Telekom, has a statutory monopoly over public, switched voice communications, both domestically and internationally. In addition, Deutsche Telekom controls interconnection to the local distribution facilities, and therefore manages the way in which its "competitors" can access customers for the limited services where competition is legally allowed.

Most countries, concerned about the effect of competition on their national carrier and their national economies, are moving only cautiously toward opening their closed markets. For example, the majority of foreign telecommunications operators are government-owned. Even those that profess to embrace pro-competitive policies have failed to develop regulatory policies that require the monopoly provider to make access to essential facilities available to potential competitors on terms that would permit the development of effective competition. In fact, few countries have established independent regulators. In addition, few countries provide for the separation of monopoly and competitive services providers or employ other safeguards that would help to ensure that competitive services are not subsidized with monopoly revenues.

Of course, such countries have the sovereign right to manage their telecommunications markets in ways that they perceive will best serve their national interests. However, when individual countries choose to keep their telecommunications markets closed to U.S. carriers, the U.S. should consider that fact in deciding whether the entry of a foreign carrier from that country into the U.S. telecommunications market is in the U.S. public interest.

While the size and openness of the U.S. telecommunications services market has attracted competition from all over the world, that open door policy has not generated comparable progress in other countries. Some foreign carriers want not only the freedom to compete and be profitable in the United States, but also freedom from competition with U.S. carriers in their home countries.

The need for effective market access is a critical issue because of the unique nature of international telecommunications services. The provision of international telecommunications services, by its very nature, absolutely necessitates a presence in two countries simultaneously to complete a call. Because other countries, in the exercise of their sovereign rights, have granted monopoly status over all traffic into and out of their country to one national carrier,

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U.S. carriers have been forced to provide international services through alliances with monopoly foreign telephone administrations.

However, multinational corporate customers for international telecommunications services are increasingly seeking a single source of supply -- providing "end-to-end", global, high-quality seamless services, including international services and domestic services originating both in the U.S. and in foreign countries. Competition for these customers' telecommunications business is fierce from both U.S. and foreign carriers. Foreign carriers have a significant competitive advantage over U.S. carriers, however, when they enter the U.S. market and offer services originating in the United States, while also controlling overseas markets that are closed to U.S. carriers. This can make all the difference in a customer's decision to purchase services from a U.S. or foreign-based carrier.

Moreover, the ability of a foreign monopoly carrier to make an equity investment in a U.S. carrier creates the financial incentive for the foreign monopoly carrier to discriminate in favor of its U.S. affiliate. If the foreign monopoly carrier controls a closed overseas market, other U.S. carriers must rely on the foreign carrier in order to offer services between the U.S. and the closed overseas market and can be severely disadvantaged by such discrimination when, for example, the foreign monopolist delays or denies the necessary service arrangements required to provide service to customers.

The economic distortions that have arisen in the international telecommunications services market can only be resolved through the opening of foreign markets and achieving full and nondiscriminatory market access. Fully competitive global markets in telecommunications would foster economically rational (e.g., cost-based) pricing and business decisions to the benefit of both carriers and consumers throughout the world.

AT&T supports the opening of telecommunications markets world-wide and believes that any country that offers U.S. carriers full and effective access to its market should have open access to the U.S. market. In particular, AT&T believes that any foreign carrier whose home country allows U.S. carriers full and effective market access in basic switched telecommunications should be free to invest in the U.S. telecommunications industry without being subject to any foreign ownership restrictions.

There is, at present, no international convention or treaty that requires a country to allow open, competitive markets in basic telecommunications services. There is hope, however, that this can be achieved through the basic telecommunications negotiations now underway within the GATS. These negotiations are a major piece of unfinished business from the Uruguay Round of multilateral trade negotiations. Basic telecommunications have been set aside for separate negotiations in the Negotiating Group on Basic Telephony (NGBT), with a deadline for completion of April, 1996. As Vice President Gore said at the G-7 Conference in Brussels last month, the GATS negotiations

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represent "a historic opportunity to open telecommunications markets around the world."

AT&T is hopeful that the GATS negotiations can produce an agreement that will give U.S. carriers effective access to global telecommunications markets. However, we have no illusion that this will be an easy task. Trade negotiations on basic telecommunications are taking place now because it was not possible to reach agreement on these issues after years of negotiations in the Uruguay Round. At that time, other countries were, for the most part, simply unwilling to open their basic telecommunications markets in any meaningful way.

There is, however, some reason to be optimistic. Since these issues were last discussed in GATS, more countries have begun active consideration of open markets and competition in telecommunications. AT&T, therefore, believes that the GATS participants should now be better positioned to take advantage of this great opportunity to transform the global telecommunications industry.

AT&T fully supports removal of the U.S. foreign ownership restrictions as part of a GATS agreement providing full and effective market access abroad for U.S. carriers. Until that agreement is reached, the restrictions should be removed on a bilateral basis for individual countries that open their markets to competition by U.S. carriers.

To help the U.S. telecommunications industry obtain the best possible result in the GATS negotiations, the U.S. should not remove its foreign ownership restrictions unilaterally.

Because the U.S. is already the most open and competitive telecommunications market in the world, it also has fewer concessions to offer other countries in these negotiations in return for their removal of their barriers to competition. An important potential concession by the U.S. is the removal of the foreign ownership restrictions.

Thus, to maintain U.S. negotiating leverage at this critical time, AT&T endorses the approach taken in the draft legislation to make the removal of the foreign ownership restriction contingent upon the opening of foreign markets to U.S. carriers. However, the legislation should also make clear that the legal right for U.S. carriers to compete in foreign markets will not be enough. U.S. carriers must obtain *effective* market access, which means the ability to compete with foreign carriers, most of which are government-owned monopolists, on fair and equal terms in their home markets.

Effective market access requires not only the ability to provide basic international and long-distance telecommunications services on both a resale and facilities basis, but also safeguards to ensure that competition is fair. Necessary safeguards include the existence of standard terms and conditions for non-discriminatory, cost-justified interconnection, and allowing customers to choose alternative carriers on an equal basis. These safeguards also include the separation of monopoly from competitive operations, or the existence of other safeguards to prevent cross-subsidization. The legislation should therefore permit the foreign ownership restriction to be waived for any foreign carrier whose home country enters into a multilateral or bilateral trade agreement providing U.S. carriers with effective market access in basic telecommunications services.

AT&T believes that consistent effective market access criteria should be used in evaluating applications from foreign carriers to enter the U.S. market. In particular, AT&T welcomes the Notice of Proposed Rulemaking released by the FCC focusing on the issue of foreign carrier entry into the U.S. The FCC is considering in this rulemaking whether to include an "effective market access" inquiry in deciding whether to grant entry to companies affiliated with foreign carriers through facility authorizations under Section 214 of the Communications Act and through Section 310(b)(4) waiver requests.

AT&T understands that the FCC plans to conclude this rulemaking on an expeditious schedule and AT&T will fully support that effort. The U.S. should establish uniform criteria that will encourage foreign governments to provide U.S. firms effective market opportunities before any other foreign-based carriers are allowed to enter the U.S. market, and before those already here are allowed to expand their operations.

The U.S. also should make affirmative use of market entry applications from foreign carriers where there is no effective market access in the foreign carrier's home market to identify areas requiring specific action. For example, where the FCC determines that effective market access does not exist in response to an application from a foreign carrier to enter the

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U.S. market, the United States Trade Representative should undertake negotiations with the government of the home country of the foreign carrier to seek an agreement to provide U.S. carriers with effective market access. AT&T believes that a requirement for a market access proceeding by the FCC, and for bilateral negotiations by USTR if effective market access is not found to exist, should also be included in the legislation being considered by this Committee.

Finally, the legislation should require that foreign carriers entering the U.S. to provide international services charge U.S. carriers non-discriminatory, cost-based accounting rates. Accounting rates determine the payments U.S. carriers make to foreign carriers for terminating overseas calls. Because the U.S. originates more traffic than it receives, there is a net $4 billion outflow in these payments, approximately one-half of which has been estimated to represent an above-cost subsidy. Further, foreign carriers often charge much higher accounting rates to U.S. carriers than to carriers from other countries, although the costs of terminating traffic from different countries are very similar. These payments by U.S. carriers to foreign monopoly carriers are costs that ultimately must be recovered from customers.

In contrast, a study by Strategic Policy Research estimates that the elimination of foreign market barriers to competition by U.S. carriers and the reduction of accounting rates to cost would result over the next ten years in the creation of 120,000 to 260,000 new U.S. jobs, cumulative growth of $120 to $210 billion in U.S. GDP, and accumulated improvement in the U.S. balance of trade of $50 to $60 billion. Likewise, a recent report by The Economic Strategy Institute estimates that U.S. carriers would obtain at least 10% of foreign, local and long distance markets and a minimum of 20% of international calls originating outside the United States if those markets were open and competitive.

We should not waste any more time on this issue. Any further delay in clarifying U.S. regulatory policies on foreign carrier entry would amount to "closing the barn door after the horse is gone." Indeed, foreign-based carriers that hold monopolies, or near monopolies, in their home markets of Canada, the U.K., Spain, Hong Kong and Australia have already entered the U.S. international market. Carriers from France and Germany have applications pending before the FCC to enter the U.S. Foreign monopoly carriers that enter the U.S. while U.S. carriers are unable to obtain effective access to the home markets of the foreign monopoly carriers are, in effect, bypassing the GATS negotiations process.

The concept of effective market access is a fair and equitable one. It is simply a recognition of the fundamental

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Strategic Policy Research, The U.S. Stake in Competitive Global Telecommunications Services: The Economic Case for Tough Bargaining (Dec. 16, 1993) at 2.

Economic Strategy Institute, Crossed Wires, How foreign Regulations and U.S. Polices are Holding Back the U.S. Telecommunications Services Industry (Dec. 1994) at 71, 73.

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fairness of requiring foreign governments to afford U.S. telecommunications carriers similar opportunities to those enjoyed by foreign-based carriers in the U.S. Effective market access abroad would allow U.S. carriers to respond more fully to customer demands for a single world-wide source of supply for their global telecommunications requirements. Most importantly, effective market access abroad is essential if U.S. carriers are to compete on a level playing field with foreign carriers that offer services originating in the U.S.

Once again, on behalf of AT&T, thank you for the opportunity to share AT&T's perspective on these important issues.

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